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Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Matters of Special Importance—2006

Main Points—Chapters 1 to 12

Appendices

Office of the Auditor General of Canada

2006



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The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents for the Report is found at the end of this publication.

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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-1E
ISBN 0-662-44365-9

Auditor General of Canada
Vérificatrice générale du Canada

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith my annual Report of 2006 to the House of Commons, which is to be laid before the House in accordance with the provisions of subsection 7(3) of the *Auditor General Act*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

OTTAWA, 28 November 2006

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Matters of Special Importance—2006



Sheila Fraser, FCA
Auditor General of Canada

My Sixth Annual Report

I am pleased to present my sixth annual report to Parliament.

Among the issues discussed in this report are three in particular that I believe are of special importance to Parliament:

- the government's Expenditure Management System,
- specific instances of unethical behaviour that continued for an unacceptable length of time, and
- limitations placed on my access to information for audit purposes.

Expenditure Management System

Demands on government are unlimited, but the resources available to meet them are not. Governments must have some means of deciding how much they can afford to spend, what to spend it on, and how to get the best results for the money. The policies, processes, and practices the federal government follows to act on these questions constitute the Expenditure Management System (EMS). The Budget, the Estimates, and the Public Accounts (announcing the surplus or the deficit for the year) are the most visible elements of the government's EMS.

The EMS is at the heart of the operation of government. It touches everything the government does, since all government activities involve spending. A system that works well promotes efficient, responsive, and accountable government. Without a good system, nothing departments and agencies do individually will result in sound overall management of government spending. An effective EMS is essential to getting the results the government wants and to being accountable to Canadians for what is done on their behalf.

The government is reviewing its Expenditure Management System

The current Expenditure Management System was designed in the mid-1990s when, facing budget deficits, the government was trying to reduce its spending. Departments and agencies had to operate in a fiscal environment that restricted new funding as much as possible. However, a system suited to times of fiscal restraint is not necessarily the best one for periods of fiscal abundance—for example, a budget surplus. Changes in the scale and nature of government spending will call for corresponding changes in how spending is managed.

In the May 2006 Budget Plan the government announced its intention to review the EMS. Based on our examination of the EMS, there are some key areas where we have made recommendations that I encourage the government to consider.

The challenge function needs improvement

One key element of the system is the challenge and review of spending proposals. Currently, the system focuses on challenging new spending proposals and, in effect, ignores ongoing spending. The government does not systematically review and challenge ongoing programs to determine whether they are still relevant, efficient, and effective.

Instead, existing programs are reviewed usually when a government wants to cut spending. The three departments we discuss in Chapter 2, Expenditure Management System in Departments, have not developed the capacity to respond to reallocation requests from the centre of government. The lack of a systematic approach limits their ability to carry out this type of exercise effectively.

Even though new spending proposals are subject to review and challenge, the existing approval process does not ensure that decisions to fund the proposed initiatives are well informed. Under the current EMS, departments may seek Cabinet approval in principle for spending initiatives without specifying how the initiative will be funded or put into effect. Cabinet committees often approve proposals without this information.

The details on the design and implementation of proposed initiatives are included later, in the department's submission to the Treasury Board for its approval. At this stage, the Treasury Board Secretariat's review of these submissions has little impact on resource allocation, because the decision to fund the initiative has already been made. What is typically decided at the Treasury Board submission stage is how the allotted money will be spent, not how much should be allotted. This restricts the ability of the Treasury Board Secretariat to meaningfully challenge the departments' proposals.

Lack of alignment of funding may jeopardize program delivery

Another element of the EMS that I encourage the government to look at is whether the amount of funding allocated to a program, the length of the funding period, and the distribution of funding over that period (the funding profile) are aligned with what is needed to deliver the program and achieve its objectives.

In Chapter 2, Expenditure Management System in Departments, we discuss a number of alignment problems. For example, temporary funding may be allocated to a program whose objectives can be achieved only over the longer term. Another alignment problem occurs when the funds are not distributed over the period of funding in the amounts needed for each year of the program.

These alignment problems affect program delivery. For example, some programs are set up to fund multi-year projects, but they receive temporary funding; the officials running such a program do not know if there will be adequate funding for the next year. As a result, they may be uncertain that the program can provide continuing support to individuals and groups that rely on it. Related difficulties include recruiting and retaining staff when only temporary positions are available. The pressures caused by alignment problems may lead to short-term solutions that can jeopardize long-term objectives.

Increased use of Supplementary Estimates limits parliamentary scrutiny

A key element of the EMS is the Main Estimates, which support the government's annual request to Parliament for authorization to spend money. In addition to the Main Estimates, Supplementary Estimates are usually presented twice during the year—in the fall and again toward the end of the fiscal year.

Since 1997, the proportion of spending proposals made through Supplementary Estimates, rather than through the Main Estimates, has increased significantly. While Supplementary Estimates are necessary in certain circumstances, I am concerned by their routine use for spending that could be proposed in the Main Estimates. What is troubling about the increased reliance on Supplementary Estimates is that it limits parliamentarians' opportunity to examine the full range of proposed government spending.

I am also concerned about the approval of Supplementary Estimates late in the fiscal year. Departments start to spend on programs and initiatives and charge the expenditures against the existing appropriations by "cash managing" until the Supplementary Estimates are approved. This puts program spending at risk, because Parliament could reduce or reject the Supplementary Estimates. It also undermines parliamentary control of government spending because the money is spent before Parliament has examined and approved the spending proposal.

I encourage the government to consider these issues in any plans it develops as a result of its own review.

Standards of ethical behaviour have been breached

While a strong expenditure management system is essential to good financial management, good systems in themselves are not enough. They must be applied correctly and ethically, as the government has recognized in its *Values and Ethics Code for the Public Service*.

The Code states that public servants shall endeavour to ensure the proper, effective, and efficient use of public money. Further, "public servants shall act at all times in a manner that will bear the closest public scrutiny, an obligation that is not fully discharged by simply acting within the law."

Unfortunately, in this report, I present a case in which a senior public servant has not met the expected standards of ethical behaviour. Chapter 11, Protection of Public Assets, details how a senior government appointee abused his position for substantial personal benefit.

To Canadians who may find these matters discouraging, I would say that, in my experience, the vast majority of the 350,000 public servants do adhere to the high standards expected of them. I therefore caution readers not to generalize isolated examples to the public service as a whole.

What particularly disturbs me about these cases is that while only a few individuals were behaving improperly, others knew about it and failed to act on that knowledge. Further, senior management knew or should have known what was going on, but took no action.

In Chapter 4, Proper Conduct of Public Business, we note the results of a survey indicating that 70 to 80 percent of employees in three public security agencies—the RCMP, Correctional Service Canada, and the Canada Border Services Agency—said they would report misconduct. However, they had significant doubts about their co-workers' willingness to do the same. This same survey indicated that a high number of employees disagreed that public servants who report misconduct in the workplace are generally respected.

The survey further indicated that employees' confidence in management support, peer support, and confidentiality for reporting wrongdoing ranges from moderate at the RCMP to low at Correctional Service Canada and the Canada Border Services Agency. Since this confidence is an important factor in an employee's willingness to report misconduct, these results are troubling.

Continued emphasis on ethics and values training is important to ensure that public servants are aware of their responsibilities, both of acting within the law, but more importantly as guardians of public trust.

Addressing this issue will take more than training. It will take visible, sustained commitment by senior management in each of their organizations to support the reporting of misconduct by assuring confidentiality and taking any action warranted. A lack of leadership by senior management can allow problems to grow and become persistent, leading to cynicism and mistrust.

Denial of access to information

Two chapters of this report note that we were unable to audit certain aspects of government operations managed by the Treasury Board Secretariat, because we were denied access to information we needed.

I consider our access to information a very serious matter and essential to meeting the standards necessary to comply with my statutory reporting duties to Parliament. In turn, Parliament's ability to hold the government to account for its stewardship of public funds depends on obtaining all the relevant information. The *Auditor General Act* requires that when access to documents or information is denied, I must inform Parliament.

My right of access to information, documents, and individuals to fulfill my audit responsibilities is entrenched in legislation, specifically section 13(1) of the *Auditor General Act*. This section provides that my right of access to information cannot be restricted except by a specific statutory provision to the contrary. The Act also clearly indicates that it is the auditors who determine what information they need to conduct and complete their audits and examinations.

The two audits for which we were denied access to information concerned the Expenditure Management System at the government centre and large information technology projects. In these audits we attempted to determine whether the Treasury Board Secretariat had adequately fulfilled its challenge and oversight responsibilities. In both audits, we were denied access to the analyses conducted by the Treasury Board Secretariat on the basis that they were Cabinet confidences of a type that is excluded from our right to access.

We appreciate the importance, in our system of government, of maintaining the confidentiality of free and frank Cabinet discussions. Since 1986, successive governments have provided us with access to

certain Cabinet confidences under the authority of an order-in-council dated December 1985. By this order, we can review Treasury Board submissions and decisions, decisions of the whole Cabinet, and certain explanations and analyses of problems or policy options contained in a memorandum or discussion paper presented to the Cabinet.

Since the completion of these two audits, officials from my Office and I have had numerous discussions on this matter with government officials. Our discussions have led to a mutually satisfactory resolution, reflected in a new order-in-council issued 6 November 2006 that clarifies my access to key information—in particular, the analyses performed by Secretariat officials from February 2006 onward. At the same time, the new order-in-council continues to respect the constitutional convention of confidentiality of Cabinet discussions. We recognize that our access to Cabinet confidences does not change their essential nature, and we are very careful in the way we treat this information.

Another aspect of this constitutional convention requires maintaining the confidentiality of the Cabinet papers of a previous ministry. Ministers of one government are not entitled to examine or release the Cabinet documents of a predecessor government, unless permission is given by the previous ministry. Accordingly, my access to Cabinet confidences that were created prior to February 2006 will continue to be governed by the 1985 order-in-council. Because the nature of our audits is to look back over time, it is possible that I may encounter similar problems in future audits. Should this situation arise, I would again report to Parliament a denial of access to information necessary to audit government activities and spending.

Nonetheless, with the new order-in-council, the government has clearly acknowledged my need for access to the analysis performed by the Treasury Board Secretariat.

I thank the government for responding to our concerns and for the resolution of this issue by the new order-in-council.

Conclusion

This year has proven to be another challenging and rewarding year. I would like to thank parliamentarians for their continued confidence in, and support for, our work. I look forward to continuing to work with parliamentary committees as they review the results of our audits. I would also like to recognize the enthusiasm and dedication of the staff of my Office, who make these reports possible.

Main Points—Chapters 1 to 12



Expenditure Management System at the Government Centre

Chapter 1 Main Points

What we examined

The Treasury Board Secretariat, the Department of Finance, and the Privy Council Office ("central agencies" of the federal government) have key roles and responsibilities in the government's Expenditure Management System (EMS). These include providing Cabinet with information to support spending allocation decisions and monitoring spending to ensure that it complies with authority and achieves the intended results. We examined the processes and procedures used by the central agencies to carry out their roles in the management of government spending. The main focus of the audit was the Treasury Board Secretariat, given its central role in the overall management of government resources.

However, we could not fully audit how the Treasury Board Secretariat reviews and challenges new spending proposals submitted to the Treasury Board. The Secretariat denied us access to the information and analysis it collects and prepares, citing Cabinet confidence of a type that cannot be disclosed to us. The government has effectively imposed a limitation on the scope of the Auditor General's examination.

Why it's important

The EMS is at the heart of government operations. The processes and procedures by which the central agencies of government support Cabinet in allocating and managing government spending are key components of the EMS. They are designed to help align resources with priorities, oversee spending, and establish the policies that departments will follow to manage and deliver their programs.

A sound and effective system for managing spending is central to the government's ability to carry out its fiscal responsibilities, fund its programs, control spending, and report financial and performance information to Parliament and the public. A system that works well promotes efficient, responsive, and accountable government. Without a good system, nothing that individual departments and agencies can do will result in sound overall management of government spending.

What we found

- Spending levels for existing programs and for new spending initiatives are approved on two separate tracks, making comparisons difficult. Spending on ongoing programs normally continues as a matter of course; new spending proposals are ranked among themselves without reference to existing programs. As a result, potential trade-offs and reallocation of resources between existing and new programs are not normally considered, except through ad hoc reviews of programs.
- The annual update of reference spending levels for ongoing programs is primarily a technical exercise that incorporates new spending approvals and adjustments for certain cost changes. It is not designed to review whether existing programs are still relevant, efficient, and effective.
- Under the current process, in effect since the late 1990s, departments may submit for Cabinet approval their proposals for new spending without specifying how the spending will be funded or put into effect. Cabinet committees therefore often approve spending initiatives without having this information before them. It is the Prime Minister and the Minister of Finance who subsequently decide on the funding of those initiatives. Details on program design and implementation are decided at the Treasury Board submission stage. The opportunity to affect spending levels at that stage is limited, however, because allocation decisions have already been made.
- The Expenditure Management System is not fully integrated with performance results. The current EMS does not require that departments submit data to demonstrate that they have used their funding effectively. The Treasury Board Secretariat has a limited capacity to monitor departments' compliance with the conditions and allotments imposed by the Treasury Board.

The government has responded. The Treasury Board Secretariat, the Department of Finance, and the Privy Council Office are in general agreement with our recommendations. Their detailed response follows each recommendation throughout the chapter. The government's overall response, included at the end of the chapter, indicates that the findings are generally consistent with its view of the present Expenditure Management System.



Expenditure Management System in Departments

Chapter 2 Main Points

What we examined

In the federal government, departments decide on the mix of resources that is appropriate to deliver programs efficiently and effectively within the amounts voted by Parliament and the policies issued by the Treasury Board.

We examined the Expenditure Management System in three selected departments: Agriculture and Agri-Food Canada, Canadian Heritage, and Public Works and Government Services Canada. We also carried out a survey of officials in ten other departments. We examined selected programs to determine whether the program managers had adequate funding over a long enough timeframe to deliver the program. We examined how departments reallocate resources—specifically, how they respond to central expenditure review—and how they comply with conditions set by the Treasury Board for funding. We also examined whether the Treasury Board Secretariat provides clear guidance on the use of Supplementary Estimates, whether departments follow the guidance, and how departments use the Supplementary Estimates process.

Why it's important

The Expenditure Management System touches everything the government does, since all government activities involve spending. A sound and effective system for managing spending is central to the government's ability to carry out its fiscal responsibilities, fund its programs, control spending, and report financial and performance information to Parliament and the public. A system that works well promotes efficient, responsible, and accountable government. Without a good system, nothing that individual departments and agencies can do will result in sound overall management of government spending.

Departments play a key role in the Expenditure Management System, with primary responsibility for managing the resources allocated to them and achieving the results expected of their programs.

What we found

- In the programs we looked at there were significant examples of funding that was not adequately aligned with what was needed to deliver the programs and achieve their objectives, in terms of the

amounts allocated, timeframes, and funding profiles (the distribution of funding over a period of time). This affected how the programs were delivered, including their ability to recruit and retain staff. Alignment problems and pressures of the annual appropriations process also led departments to rely on cumbersome ad hoc measures to meet spending commitments.

- The capacity to respond to some elements of government-wide reallocation exercises was insufficient in the three departments we examined. In the case of the 2004 Expenditure Review Committee exercise, they responded largely with financial information that was not adequately combined with information on performance. The lack of a systematic government approach to central expenditure reviews is an underlying cause of these problems.
- In recent years, an increasing proportion of spending items has appeared in Supplementary Estimates rather than in Main Estimates. This limits parliamentarians' opportunity to scrutinize the full range of proposed government spending. The Treasury Board Secretariat has recognized the need to consolidate spending items in the Main Estimates. However, little has been done to reduce departments' reliance on Supplementary Estimates. In addition, departments start to spend on items in the Supplementary Estimates using existing authorities but before Parliament has voted on the Estimates. This practice undermines parliamentary control of government spending and exposes program funding to the risk that Parliament might reduce or reject the Supplementary Estimates.

The government has responded. The government considers that the issues raised in the chapter are generally consistent with those that a new Expenditure Management System should address, including the objective of reducing the use of Supplementary Estimates. It is reviewing the issue of alignment in order to identify areas of improvement, and agrees with the need to redesign the process for central expenditure review.



Large Information Technology Projects

Chapter 3 Main Points

What we examined

The many large information technology projects now under way across the federal government are no longer only about introducing new computer hardware, software, or systems. They are meant to help departments change the way they do business—for example, by introducing new processes and modernizing work practices.

We examined a sample of seven large IT projects from four perspectives:

- **Governance.** Did the processes used by the government to approve and manage large IT projects increase the project's likelihood of success?
- **Business case.** Did the department or agency proposing the project clearly define the business needs it expected the project to meet?
- **Organizational capacity.** Did the department have people with the needed skills and experience to manage a large IT project and did the organization have the ability to use all of a system's capabilities to improve the way it does business?
- **Project management.** Did the department follow accepted best practices in managing the project?

We also attempted to examine the role the Treasury Board Secretariat played in the challenge and oversight of these large information technology projects. However, we could not audit this role because we were denied access to most of the information and analysis it collects and prepares. The government has effectively imposed a limitation on the scope of the Auditor General's examination.

Why it's important

Few departments today can deliver their business without the support of their IT. Governments must deliver successful IT projects if they are to provide their services to the public economically, efficiently, and effectively. Large IT projects are becoming more complex than ever and often involve a growing number of players across government.

In the last three years, the federal government has approved funding of $8.7 billion dollars for new business projects with significant use of IT.

Despite their importance to departments, large IT projects have had a history of overspending, delays, performance shortfalls, and abandonment after major investments. Understanding why some projects have succeeded while others have failed would better position the government to plan and manage IT projects for success, maximizing the benefits of its investment in information technology by giving departments effective tools for delivering services.

What we found

- Only two of the seven projects we looked at: the 2006 Census Online and My Account, My Business Account projects met all of our audit criteria for well-managed projects.
- Overall, the government has made limited progress since our last audit of IT projects in 1997. Although since 1998 the Treasury Board Secretariat has established a framework of best practices for managing IT projects, many of the problems we cited in past reports have persisted.
- The quality of governance varied widely from project to project. In four of the seven projects we found that governance responsibilities were not carried out adequately because key issues that impacted project performance were either not reported or not resolved.
- Five of the seven projects we looked at were allowed to proceed with a business case that was incomplete or out-of-date or contained information that could not be supported.
- Four of the projects were undertaken by departments that lacked the appropriate skills and experience to manage the projects or the capacity to use the system to improve the way they deliver their programs.
- Depending on the project, the quality of project management ranged from good to seriously flawed. In two cases, poor project management led to long delays and large cost overruns.

The government has responded. The Treasury Board Secretariat, on behalf of the government and the federal organizations we audited, agrees with all of our recommendations. In its responses, the Secretariat describes the actions they will take to address the recommendations.



Proper Conduct of Public Business
Public Safety and Emergency Preparedness Agencies

Chapter 4 Main Points

What we examined

When public business is conducted properly, public servants comply with laws and policies and use public funds and other assets entrusted to them to benefit the public and not themselves.

We examined key aspects of the proper conduct of public business in three agencies: the Royal Canadian Mounted Police (RCMP), Correctional Service Canada, and the Canada Border Services Agency. We looked at whether each agency has values and ethics programs that promote good behaviour and has internal disclosure (or "whistle-blowing") policies that support the reporting of wrongdoing. We also examined the role that internal audit plays in verifying compliance with laws, policies, and regulations.

We looked at three areas where we believe a risk of abuse is present—contracting, use of acquisition (credit) cards, and use of overtime and leave.

We did not look at issues such as the use of excessive force, harassment, or security breaches.

Why it's important

Misuse and abuse of public resources has become a major concern to Parliament and to Canadians in general. Over the last five years, the federal government has made a major investment in values and ethics programs, has introduced whistle-blower legislation in Parliament, and has begun strengthening internal audit in departments and agencies.

The three public safety agencies we audited employ a total of about 40,000 public servants and spend a total of about $5.6 billion each year, making them a significant factor in the conduct of the federal government overall.

What we found

- Although the two-year-old Canada Border Services Agency is still developing its programs, all three agencies generally have in place programs of values and ethics, internal disclosure, and internal audit. However, only about 20 percent of employees report having received training in values and ethics. Our survey of 400 non-management

employees in the three agencies showed that no more than half are familiar with agency values and ethics programs.

- Our analysis found that having programs in place is not enough alone to encourage employees to report wrongdoing by colleagues. They also need to know that management will follow up on their reports and will preserve their confidentiality, and that their peers will continue to respect them. While 70 to 80 percent of employees said they themselves would report misconduct, they had significant doubts about their co-workers' willingness to do so. The extent to which management was perceived to take reports of wrongdoing seriously and investigate them ranged from 60 percent at the RCMP to a low of 45 percent at the Border Services Agency.
- We found few cases of abuse of leave in order to generate excessive overtime.
- We found that all three agencies had improperly sole-sourced contracts, to the detriment of fairness and equal access—two principles that government agencies are required to apply in the proper conduct of their contracting activities. The Canada Border Services Agency and Correctional Service Canada did not have adequate quality assurance practices in place for contracting activities.
- We found outright abuse of acquisition cards in only a small number of cases. Nevertheless, the RCMP and the Canada Border Services Agency had high levels of non-compliance with the rules. We also found that purchase limits had been exceeded, and purchases were sometimes split into two bills to evade controls. There was poor control at all three agencies, with individuals allowed to verify their own purchases and documentation frequently lacking. The Treasury Board's policy explicitly forbids the use of acquisition cards for vehicle operations and maintenance, but the Treasury Board Secretariat has allowed it in practice. This has led to a "grey area" in how agencies view the rules and has reduced value for money in some cases.

The agencies have responded. The agencies generally agreed with our findings and most recommendations.



Relocating Members of the Canadian Forces, RCMP, and Federal Public Service

Chapter 5 Main Points

What we examined

The Integrated Relocation Program was designed to improve the quality of life of transferred members of the Canadian Forces, the RCMP, and the federal public service. It does this by providing flexible relocation benefits and reimbursing reasonable relocation expenses. We examined how the government awarded the current contracts. We looked at each stage of the process to determine whether government contracting policies and regulations had been respected. We also examined the extent to which the Treasury Board Secretariat and the departments involved had established appropriate measures of the contracts' performance.

While this chapter includes the names of various contractors, it must be noted that our conclusions about management practices and actions refer only to those of government departments. The rules and regulations we refer to are those that apply to public servants; they do not apply to contractors. We did not audit the records of the private sector contractors. Consequently, our conclusions cannot and do not pertain to any practices that contractors followed. We did not assess individual expense claims made by relocated employees or activities related to the moving of household goods.

We conducted our audit in response to a November 2005 request by the Public Accounts Committee.

Why it's important

The relocation program handles about 15,000 relocations a year across the government, the RCMP, and the Canadian Forces, at a cost of about $272 million in 2005.

The government has said that the purpose of the relocation program is to improve the quality of life for transferred employees and reduce the detrimental effects of relocation on departmental operations. Knowing how to gauge the program's success at meeting these goals is important for the government in a contract of this size. Ensuring that the public servants involved in awarding the contract have diligently followed the rules and applied the principles of fairness and transparency is vital to the credibility of the government's procurement process.

What we found

- We have concluded for two reasons that the contracts were not tendered in a fair and equitable manner. First, some of the business volumes incorporated into the request for proposal by the Treasury Board Secretariat, the Canadian Forces, and the RCMP contained materially incorrect information. Second, although PWGSC followed its established processes, these steps were not sufficient—particularly when concerns had been raised—to offset an unfair advantage the incumbent bidder had attained through its work on a prior contract and to ensure that all bidders in the tendering process had access to correct and complete information.
- Except for an inappropriate comparison of bids during the evaluation process, the evaluation of the technical portion of the bids was conducted in accordance with the Treasury Board Contracting Policy.
- Neither the Treasury Board Secretariat nor departments have developed performance measures to demonstrate whether the Integrated Relocation Program is achieving its objectives or has realized any cost savings.
- National Defence has not established adequate controls to ensure that amounts reimbursed to the contractor for relocation services provided to transferred Canadian Forces members represent valid payments and are consistent with the relocation policy.
- Members of the Canadian Forces have been charged amounts for property management services in excess of rates established in the contract.

The Treasury Board Secretariat and the departments have responded. The Treasury Board Secretariat, the RCMP, National Defence (Canadian Forces), and Public Works and Government Services Canada have agreed with our recommendations. Their detailed responses follow the recommendations in the chapter.



Old Age Security

Human Resources and Social Development Canada and Service Canada

Chapter 6 Main Points

What we examined

The Old Age Security program pays three benefits to seniors, each with its own eligibility conditions—the Old Age Security (OAS) pension, the Guaranteed Income Supplement (GIS), and the Allowance. Human Resources and Social Development Canada and Service Canada manage the program. We examined whether these organizations provide adequate access to program benefits, have reasonable assurance that correct benefits are paid to eligible beneficiaries, and record and collect overpayments in accordance with legislation and policy.

The reporting of the audit, originally scheduled for April 2006, was deferred because of changes to the parliamentary calendar as a result of the federal election. To update our observations, in August 2006 we obtained information from both organizations on any action they may have taken to address the observations and recommendations in this chapter. We have provided that information under **Subsequent events**.

Why it's important

The Old Age Security program provides a basic income for its beneficiaries, many of whom have little other income. The number of beneficiaries is expected to double in the next 25 years. It is important that the program be managed in such a way that everyone who is entitled to benefits is able to apply for and receive them.

More than 4 million people receive OAS benefits amounting to a total of about $28 billion each year—14 percent of the federal government's total yearly spending. With so many current beneficiaries and still more to come in the future, errors that affect even a small proportion of clients or payments can involve relatively large numbers of individuals or large amounts of money. To demonstrate good stewardship of public funds, those who deliver the program need to understand and manage the risks involved.

What we found

- Human Resources and Social Development Canada and Service Canada have improved seniors' access to program benefits by simplifying the application process and by implementing initiatives to

increase the take-up of GIS. However, the organizations lack adequate information on these and other aspects of their service to clients, and do not give Parliament a complete picture of program performance.

- Quality reviews by Service Canada staff in processing centres, as well as our own testing, suggest that errors in establishing monthly payment amounts at the time of application occur at relatively low rates. However, because payment accuracy is not measured systematically, there is no assurance that this will be sustained. Moreover, the quality of application processing is not monitored adequately, and quality deficiencies occur at significantly varying rates from one quality review to another. Quality deficiencies—failures to follow processing policies and procedures—can lead to payment errors. Practices for updating accounts and assessing continuing eligibility are also not consistent from one processing centre to another.
- Human Resources and Social Development Canada and Service Canada do not have the consolidated information they need to properly manage overpayments. They lack a consistent approach to collecting overpayments across all processing centres. Further, the two organizations do not charge interest on OAS overpayments, despite a legislative requirement to do so.
- Information provided in August 2006 by Human Resources and Social Development Canada and Service Canada indicates that they have begun action to strengthen their management of the OAS program. They indicated that, by the end of 2007, they will have collected and reported improved information on client satisfaction and services, implemented a national quality review system, and improved information on overpayments. They also plan to issue a revised policy on managing overpayments.

Human Resources and Social Development Canada and Service Canada have responded. Human Resources and Social Development Canada and Service Canada have agreed with each of our recommendations and have committed to take action. Their responses are included throughout the chapter.



Federal Participation in the British Columbia Treaty Process

Indian and Northern Affairs Canada

Chapter 7 Main Points

What we examined

The British Columbia treaty process is intended to reconcile claimed Aboriginal rights and title to land with the Crown's assertion of sovereignty. The resulting treaties are aimed at settling uncertainty about the use, management, and regulation of land and resources and the laws that apply to the land and the people. Indian and Northern Affairs Canada (INAC) represents the federal government in the B.C. treaty negotiations. First Nations (individual communities or groups) and the Province of British Columbia are the two other parties in these negotiations.

We examined INAC's participation in the treaty process and the results of its activities. We looked at the management procedures and processes and the resources used to develop and implement federal policies that apply to treaty negotiations; our audit also covered, where relevant, support provided to the treaty process by other federal departments. We interviewed officials of INAC and of other departments and reviewed relevant files and documents; we also sought the views of First Nations communities and organizations and of the British Columbia Treaty Commission.

Why it's important

From 1993 to 2006 the federal government has spent about $426 million on B.C. treaty negotiations, and B.C. First Nations have borrowed close to $300 million for the same purpose. To date, no treaties have been signed under the B.C. treaty process, although two final agreements are seen as imminent, with a third close behind. The costs to Canada and First Nations for negotiations continue to grow.

Settling the uncertainty associated with unresolved land claims in British Columbia is important for all Canadians. It can help First Nations people living in B.C. narrow the gap between their standard of living and that of other British Columbians. In addition, studies have indicated that this uncertainty results in lost economic opportunities.

What we found

- While some treaties are expected to be signed in the near future, most negotiations are either inactive or are making limited progress. Moreover, about 40 percent of First Nations (*Indian Act* bands) are not participating in the treaty process, and there is a growing number of activities outside the process that are being used to deal with questions related to Aboriginal rights and title.
- Although the policy process has been able to respond to some issues raised during negotiations, several other issues remain to be addressed. For example, due to changes in the legal environment, dealing with overlapping claims may make concluding treaties more complex.
- In 1991 the federal government expected that all land claims in B.C. would be resolved by the year 2000. As of 2006, no treaties have been signed under the B.C. treaty process and INAC does not have the management systems in place to be able to estimate how much time and what resources will still be needed to negotiate treaties with First Nations and groups presently in the process.

The Department has responded. Indian and Northern Affairs Canada has accepted all of the Auditor General's recommendations and has committed to take action. The Department's responses follow the recommendations throughout the chapter.



Allocating Funds to Regulatory Programs
Health Canada

Chapter 8 Main Points

What we examined

Health Canada is responsible for regulating the safety and use of a wide range of items that Canadians commonly use. We examined both the process by which Health Canada decides what resources to allocate to each of its branches and the information used as the basis for resource allocation. We looked in particular at how branches allocate resources to three regulatory programs: product safety, drug products, and medical devices. We examined the impact of the Department's resource allocation process on its ability to carry out its regulatory responsibilities in these areas. The audit focused on fiscal years 2003–04 and 2004–05.

Why it's important

When Canadians use products regulated by Health Canada—whether household products such as cribs, medical devices such as blood test kits, or prescription drugs—they expect that as long as they follow directions, the product will be safe to use. Programs that regulate these products need enough resources to ensure that Canadians are adequately protected from risks to their health and safety. Health Canada, as a regulator, needs to be able to demonstrate that it is fully meeting its regulatory responsibilities.

What we found

- Program managers have indicated to branch management that some core compliance and enforcement activities are insufficient to protect Canadians' health and safety. While the total funding allocated to two of the three audited programs has remained constant, all three programs audited received less funding for core activities in 2005–06 than in 2003–04. Meanwhile, the complexity of programs and the growing demands on programs could significantly affect Health Canada's ability to meet its regulatory responsibilities.
- Health Canada has not set performance targets for all of the compliance and enforcement activities of the programs we audited. It has not determined the level of activities the programs must carry out to meet the Department's regulatory responsibilities, or the level of resources they would need to do so. Therefore, it does not know if it is fully meeting its responsibilities as the regulator of drug products, medical devices, and product safety.

- Program managers do not always have complete information to decide on how best to allocate their resources. There is limited information on the required level of program performance and the funding needed for the programs to meet its legislative requirements. There is also limited information on the results achieved for the funding received by the programs. This makes it difficult for program managers to determine the level of funding each activity needs if it is to provide Canadians with the appropriate level of protection.
- In the absence of a baseline, program managers use their experience and knowledge of their programs to report to branch management on funding shortfalls and unfulfilled regulatory responsibilities. Furthermore, the Departmental Executive Committee does not routinely receive information on how well Health Canada is fulfilling its core role as regulator, even though the Committee is the only group in Health Canada that can address cross-branch funding issues.
- Health Canada is taking steps to improve its resource allocation process. The Department has redesigned the operational planning process that will be implemented in 2006–07. This is intended to standardize the process, document decisions, and communicate to senior management the expected results based on the funding approved.

Health Canada has responded. Health Canada agrees with our recommendations. Its detailed responses follow the recommendations throughout the chapter.



Pension and Insurance Administration
Royal Canadian Mounted Police

Chapter 9 Main Points

What we examined

In 2003, allegations of fraud and abuse in the management of the Royal Canadian Mounted Police's pension and insurance plans triggered an internal audit, which was followed by a criminal investigation by the Ottawa Police Service (OPS). In June 2005, the OPS announced that its 15-month investigation had found abuses of the pension and insurance plans, nepotism, wasteful spending, and override of controls by management. Significant unnecessary or wasteful expenditures resulted, including money spent for work of little value. The Crown counsel advised that there was "no reasonable prospect of conviction on criminal charges". However, two senior officials of the Royal Canadian Mounted Police (RCMP) resigned, and the RCMP considered disciplinary action against others.

We examined whether the RCMP has responded adequately to the findings of the internal audit and the criminal investigation. We examined certain amounts spent on pension and insurance administration. We also examined additional allegations that were brought to our attention during the course of our audit. Finally, we looked at whether the OPS investigation was independent of, and conducted without undue direction or bias by, the RCMP.

While this chapter refers to certain organizations outside the Government of Canada, it must be noted that our conclusions about management practices and actions refer only to those of public servants. We did not audit the records of the external organizations. Consequently, our conclusions cannot and do not pertain to any practices that they followed.

The RCMP pension plan is separate from the Public Service pension plan. It is governed by the *RCMP Superannuation Act* and provides pension benefits to all employees classified as regular or civilian members of the RCMP. The RCMP is responsible for both the management of the plan and the preparation of its financial statements. The Pension Fund, created in April 2000, along with the RCMP Superannuation Account, had a total balance of $12.3 billion

at the time of our audit. It costs the RCMP from $6 million to $14 million a year for pension administration.

The RCMP also provides group life and disability insurance benefits to its regular and civilian members, based to a large extent on members' contributions. The various insurance plans have roughly $30 million on deposit and cost a little over $2 million a year for the RCMP to administer.

Why it's important

RCMP members serve and provide their contributions with the expectation of receiving pension benefits upon retirement in accordance with the *RCMP Superannuation Act*. In addition, insurance contributions represent an investment by members in their future financial security. RCMP plan administrators have an obligation to manage the plans with due diligence, in good faith and in accordance with public service ethics and values. Sound staffing and contracting controls and corporate oversight of senior officials' actions are essential to ensuring that these obligations are met.

What we found

- The RCMP responded adequately to its internal audit and the OPS investigation, but there are still matters that remain unresolved.
- The OPS told us that its investigation was not directed or influenced in any way by the RCMP. The Ottawa Police investigators had direct access to their own senior management and to Crown counsel throughout the investigation. However, the terms of reference for the investigation stated that the lead OPS investigator on the case reported directly to an assistant commissioner of the RCMP. This did not give the investigation an appearance of independence. We found that the RCMP does not have an established policy for ensuring that external investigations of its actions at its request are performed, and are seen to be performed, in an independent and unbiased manner.
- The RCMP reimbursed or credited about $3.4 million to the pension plan for expenses charged to the plans improperly, and it has taken measures to prevent inappropriate charges in the future. It has also taken steps to strengthen controls over staffing, contracting, and review of business cases and information provided to the Treasury Board.
- An estimated $1.3 million was charged to the pension and insurance plans to pay for commissions or products that provided little or no value, and for excessive payments to employees' friends and family members hired as temporary staff. The pension plan has been reimbursed or credited $270,280 of those unnecessary or wasteful expenditures.

- Even though an RCMP disciplinary investigation found that proceeding with disciplinary action was warranted against four of its regular and civilian members, the RCMP decided not to take action as too much time had elapsed.

The RCMP has responded. The Royal Canadian Mounted Police has agreed with each of our recommendations and is in the process of taking corrective action.



Award and Management of a Health Benefits Contract

Public Works and Government Services Canada and Health Canada

Chapter 10 Main Points

What we examined

Health Canada is responsible for providing non-insured health benefits such as drugs and medical supplies to eligible First Nations people and Inuit. In 1997, Public Works and Government Services Canada (PWGSC) awarded a contract to First Canadian Health Management Corporation Inc. to provide claim processing services for Health Canada's Non-Insured Health Benefits (NIHB) program. We looked at whether PWGSC complied with the government's contracting policy when it awarded the contract and whether Health Canada exercised adequate control over public funds spent on the program.

We did not audit claimants' eligibility for the program because we had concluded in an earlier audit (November 2004 Report, Chapter 4, Management of Federal Drug Benefit Programs) that Health Canada had an adequate process to confirm the eligibility of clients and the validity of the drug benefits before approving payments. During that audit, the government's contract with First Canadian Health Management Corporation Inc. came to our attention and we decided to audit the contract the following year.

The reporting of this audit, originally scheduled for April 2006, was deferred because of changes in the parliamentary calendar as a result of the federal election. To update our observations, in August 2006 we obtained information from both organizations on any action they may have taken to address the observations and recommendations in this chapter. We have provided that information at the end of the chapter under **Subsequent Events**.

Our conclusions about contract management practices and actions refer only to public servants and not to any actions by the contractor. The rules and regulations we refer to apply to public servants; they do not apply to contractors. We did not audit the records of the contractor.

Why it's important

From the start of the contract in 1998 until January 2006, Health Canada spent about $104 million on fees to process claims for about $2.6 billion worth of drugs and dental and medical supplies and

equipment delivered to eligible First Nations people and Inuit. Given the importance of the goods and services being provided, as well as the cost of delivering them, it is essential that in contracting for these services, officials at PWGSC and Health Canada protect the interests of the Crown by ensuring that they comply with applicable acts and regulations, including sections 32, 33, and 34 of the *Financial Administration Act*. These sections ensure that the money to pay for the services is available (s 32), that the charge is lawful (s 33), and that the government received what it paid for (s 34).

What we found

- PWGSC could not demonstrate that any of the bidders for the contract had provided evidence of financial stability, even though it was one of the mandatory requirements. Therefore, PWGSC should not have awarded the contract to any of the bidders.
- From 1998 to January 2006, Health Canada did not comply with provisions of the *Financial Administration Act* by making payments of about $2.6 billion to First Canadian Health Management Corporation Inc. (FCH) without the certification required under sections 33 and 34 of the Act.
- Between 1998 and 2003, Health Canada annually tracked payments made to FCH for processing claims. However, it did not track the payments cumulatively over the life of the contract, as section 32 of the *Financial Administration Act* requires. Although the services Health Canada paid for were delivered, payments exceeded the initial value of the contract by $24 million. Since 2003, Health Canada has been tracking payments on a multi-year basis in compliance with section 32 of the Act.
- Our audit work to update our observations found that PWGSC and Health Canada have resolved the contract management issues raised in this chapter. Nonetheless, our mandate requires that we bring to Parliament's attention any matters whose nature and significance warrants it. We are reporting these issues because of their seriousness and the length of time during which some basic financial management controls relating to this contract were lacking.

The departments have responded. PWGSC and Health Canada responded positively to our recommendations and have taken corrective actions. Their responses are included in this chapter.



Protection of Public Assets
Office of the Correctional Investigator

Chapter 11 Main Points

What we examined

The Office of the Correctional Investigator (OCI) acts as an ombudsman for federal offenders. It investigates complaints of individual offenders and tries to resolve them by making recommendations to Correctional Service Canada.

We examined whether the former Correctional Investigator's and OCI managers' personal leave, absences, cash-out of annual leave (vacation leave), and travel and hospitality expense claims complied with the *Financial Administration Act* and applicable Treasury Board policies, and whether they were managed with prudence and probity. Further, we examined whether the OCI's human resources management practices complied with Public Service Commission policies and applicable Treasury Board policies and practices. Our audit covered the period from 1 April 1998 to 31 March 2004; however, some transactions relating to annual leave were examined back to an earlier date. The audit included current and former OCI employees at the executive level, as well as the former Correctional Investigator who headed the agency during the audited period.

We also examined whether Public Safety and Emergency Preparedness Canada (formerly the Department of the Solicitor General), in providing the OCI with financial and human resources services, complied with the *Financial Administration Act*, applicable Treasury Board policies and practices, and Public Service Commission policies. We examined whether the Treasury Board Secretariat, the Public Service Commission, and the Privy Council Office carried out adequate oversight of the OCI.

Why it's important

To maintain the public's trust and confidence in government, agency heads and senior management are required to discharge their responsibilities in accordance with the highest ethical standards of integrity, objectivity, and impartiality. Their conduct and their actions are expected to exemplify the values of the public service.

Appropriate comptrollership and management are essential in any federal organization to manage financial risks and protect against

fraud, financial negligence, violations of financial rules or principles, and losses of assets or public money.

What we found

- The former Correctional Investigator and head of the OCI, Mr. Ronald Stewart, committed serious abuses and wrongdoing, some of which resulted in substantial personal benefit. For example, he received improper payments in the form of unearned salary and reimbursement of travel and hospitality expenses unrelated to OCI business.
- The former Correctional Investigator did not report a single day of annual leave (vacation leave) for 14 years. He received payments for the full amount of his annual leave entitlements for 14 years. During the 6-year audit period, he was frequently absent from the OCI premises during business days without undertaking OCI business.
- Poor and inappropriate human resources management practices at the OCI had serious financial implications. For example, the former Correctional Investigator authorized improper payments to employees that were recorded as overtime.
- The Executive Director of the OCI was aware of some of the improper activities but took no action to stop them.
- Public Safety and Emergency Preparedness Canada did not challenge questionable expenditures and reimbursements, and problematic human resources classification and staffing practices approved by the former Correctional Investigator.
- The Privy Council Office and the Treasury Board Secretariat issued general guidance material to deputy heads (agency heads) and managers of departments and agencies, but did not carry out appropriate oversight of the OCI that could have enabled them to identify and stop the improper activities.

The organizations have responded. The organizations agreed with all of our recommendations. Detailed responses follow the recommendations throughout this chapter.



Role of Federally Appointed Board Members

Sustainable Development Technology Canada

Chapter 12 Main Points

What we examined

Sustainable Development Technology Canada (SDTC) is a not-for-profit foundation established by the federal government to support the development and demonstration of technologies related to climate change, clean air, clean soil, and clean water. The government has provided it with $550 million under three successive funding agreements with Natural Resources Canada and Environment Canada.

In the third funding agreement, signed in March 2005, the government introduced a change that affected the role of those members of the SDTC Board of Directors who were federally appointed. This raised certain concerns about the governance of the Foundation, which we decided to examine.

Why it's important

In a "board-centred" model of governance, the board of directors is responsible for the supervision of the business and affairs of the organization. The government has acknowledged that federally appointed members of the boards of directors of foundations such as SDTC are obliged, like every other board member, to act in the best interests of the organization.

What we found

- Seven of the fifteen members of SDTC's Board are appointed by the federal government. The government's change to its funding agreement with the Foundation prevents the Board from making any decisions in a meeting where a majority of members present are government appointees. To resolve this problem, the Board passed a by-law providing for a subsequent vote by the other board members, but directors told us that the process is inefficient and hampers the Board's ability to operate. Given that the Board generally meets only four times a year, the change in the funding agreement makes it difficult for the Board to govern the Foundation's affairs.
- The government's change in the funding agreement interfered with the ability of federally appointed directors to carry out their duties.

The government has responded. Natural Resources Canada and Environment Canada agreed with our recommendation on behalf of the government. They have undertaken consultations with the Treasury Board Secretariat and the Privy Council Office regarding restrictions on the participation of federal appointees on the SDTC Board.

Appendices

Appendix A *Auditor General Act*

Short Title

Short title

1. This Act may be cited as the *Auditor General Act*.

Interpretation

Definitions

2. In this Act,

"appropriate Minister" "appropriate Minister" has the meaning assigned by section 2 of the *Financial Administration Act*;

"Auditor General" "Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"category I department" "category I department" means

(a) any department named in Schedule I to the *Financial Administration Act*,

(b) any department in respect of which a direction has been made under subsection 24(3), and

(c) any department set out in the schedule;

"Commissioner" "Commissioner" means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);

"Crown corporation" "Crown corporation" has the meaning assigned to that expression by section 83 of the *Financial Administration Act*;

"department" "department" has the meaning assigned to that term by section 2 of the *Financial Administration Act*;

"funding agreement" "funding agreement", in respect of a corporation, means an agreement in writing under which the corporation receives funding from Her Majesty in right of Canada, either directly or through an agent or mandatary of Her Majesty, including by way of a loan, but does not include a construction contract, a goods contract or a service contract;

"not-for-profit corporation" "not-for-profit corporation" means a corporation no part of whose income is payable to or otherwise available for the personal benefit of any of its members or shareholders;

"recipient corporation" "recipient corporation" means any not-for-profit corporation, or any corporation without share capital, that has, in any five consecutive fiscal years, received a total of $100,000,000 or more under one or more funding agreements, but does not include any such corporation that is

(a) a Crown corporation,

(b) a departmental corporation as defined in section 2 of the *Financial Administration Act*,

(c) a municipality,

(d) a cooperative, other than a non-profit cooperative,

(e) a corporation that receives, on an ongoing basis, at least half of its funding from a municipality or the government of a province or of a foreign state, or from any agency of a municipality or any such government,

(f) a corporation that is controlled by a municipality or a government other than the Government of Canada, or

(g) an international organization;

"registrar" "registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act*;

"sustainable development" "sustainable development" means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;

"sustainable development strategy" "sustainable development strategy", with respect to a category I department, means the department's objectives, and plans of action, to further sustainable development.

Control **2.1** (1) For the purpose of paragraph (f) of the definition "recipient corporation" in section 2, a municipality or government controls a corporation with share capital if

(a) shares of the corporation to which are attached more than fifty per cent of the votes that may be cast to elect directors of the corporation are held, otherwise than by way of security only, by, on behalf of or in trust for that municipality or government; and

(b) the votes attached to those shares are sufficient, if exercised, to elect a majority of the directors of the corporation.

Control

(2) For the purpose of paragraph (f) of the definition "recipient corporation" in section 2, a corporation without share capital is controlled by a municipality or government if it is able to appoint the majority of the directors of the corporation, whether or not it does so.

Auditor General of Canada

Appointment and tenure of office

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem

(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment

(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Vacancy

(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General.

Salary

4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him.

Duties

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act.

Idem

6. The Auditor General shall examine the several financial statements required by section 64 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

Annual and additional reports to the House of Commons

7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency;

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or

(f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Submission of annual report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before December 31 in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Notice of additional reports to Speaker and tabling in the House of Commons

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

Submission of additional reports to Speaker and tabling in the House of Commons

(5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Inquiry and report

7.1 (1) The Auditor General may, with respect to any recipient corporation, inquire into its use of funds received from Her Majesty in right of Canada and inquire into whether

(a) the corporation has failed to fulfil its obligations under any funding agreement;

(b) money the corporation has received under any funding agreement has been used without due regard to economy and efficiency;

(c) the corporation has failed to establish satisfactory procedures to measure and report on the effectiveness of its activities in relation to the objectives for which it received funding under any funding agreement;

(d) the corporation has failed to faithfully and properly maintain accounts and essential records in relation to any amount it has received under any funding agreement; or

(e) money the corporation has received under any funding agreement has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Report

(2) The Auditor General may set out his or her conclusions in respect of an inquiry into any matter referred to in subsection (1) in the annual report, or in any of the three additional reports, referred to in subsection 7(1). The Auditor General may also set out in that report anything emerging from the inquiry that he or she considers to be of significance and of a nature that should be brought to the attention of the House of Commons.

Special report to the House of Commons

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*,

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the federal public administration of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board.

Access to Information

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the federal public administration such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada.

Staff of the Auditor General

Officers, etc.

15. (1) The officers and employees that are necessary to enable the Auditor General to perform his or her duties are to be appointed in accordance with the *Public Service Employment Act* and, subject to subsections (2) to (5), the provisions of that Act apply to those officers and employees.

Public Service Employment Act – employer and deputy head

(2) The Auditor General may exercise the powers and perform the functions of the employer and deputy head under the *Public Service Employment Act* within the meaning of those terms in subsection 2(1) of that Act.

Public Service Employment Act —Commission

(3) The Auditor General may, in the manner and subject to the terms and conditions that the Public Service Commission directs, exercise the powers and perform the functions of that Commission under the *Public Service Employment Act*, other than its powers and functions in relation to the hearing of allegations by a candidate under sections 118 and 119 of that Act and its power to make regulations.

Delegation

(4) The Auditor General may authorize any person employed in his or her office to exercise and perform, in any manner and subject to any terms and conditions that he or she directs, any of his or her powers and functions under subsections (2) and (3).

Sub-delegation

(5) Any person authorized under subsection (4) may, subject to and in accordance with the authorization, authorize one or more persons under that person's jurisdiction to exercise any power or perform any function to which the authorization relates.

Appointment of Commissioner

15.1 (1) The Auditor General shall, in accordance with the *Public Service Employment Act*, appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.

Commissioner's duties

(2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development.

Responsibility for human resources management

16. The Auditor General is authorized, in respect of persons appointed in his or her office, to exercise the powers and perform the functions of the Treasury Board that relate to human resources management within the meaning of paragraph 7(1) (e) and section 11.1 of the *Financial Administration Act*, as well as those of deputy heads under subsection 12(2) of that Act, as that subsection reads without regard to any terms and conditions that the Governor in Council may direct, including the determination of terms and conditions of employment and the responsibility for employer and employee relations.

Delegation

16.1 (1) The Auditor General may authorize any person employed in his or her office to exercise and perform, in any manner and subject to any terms and conditions that he or she directs, any of his or her powers and functions in relation to human resources management.

Sub-delegation

(2) Any person authorized under subsection (1) may, subject to and in accordance with the authorization, authorize one or more persons under that person's jurisdiction to exercise any power or perform any function to which the authorization relates.

Contract for professional services

16.2 Subject to any other Act of Parliament or regulations made under any Act of Parliament, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his or her office in appropriation Acts, contract for professional services.

Classification standards

17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office.

Delegation

18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act, and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General.

Estimates

Estimates

19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office.

Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General.

Audit of the Office of the Auditor General

Audit of the office of the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting.

Sustainable Development

Purpose

21.1 The purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,

(a) the integration of the environment and the economy;

(b) protecting the health of Canadians;

(c) protecting ecosystems;

(d) meeting international obligations;

(e) promoting equity;

(f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;

(g) preventing pollution; and

(h) respect for nature and the needs of future generations.

Petitions received

22. (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

Acknowledgement to be sent

(2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

Minister to respond

(3) The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within

(a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or

(b) any longer time, where the Minister personally, within those one hundred and twenty days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.

Multiple petitioners

(4) Where the petition is from more that one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them.

Duty to monitor

23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor

(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before the House of Commons under section 24; and

(b) the replies by Ministers required by subsection 22(3).

Commissioner's report

(2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including

(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before that House under section 24;

(b) the number of petitions recorded as required by subsection 22(1), the subject-matter of the petitions and their status; and

(c) the exercising of the authority of the Governor in Council under any of subsections 24(3) to (5).

Submission and tabling of report

(3) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next fifteen days on which that House is sitting after the Speaker receives it.

Strategies to be tabled

24. (1) The appropriate Minister for each category I department shall cause the department to prepare a sustainable development strategy for the department and shall cause the strategy to be laid before the House of Commons

(a) within two years after this subsection comes into force; or

(b) in the case of a department that becomes a category I department on a day after this subsection comes into force, before the earlier of the second anniversary of that day and a day fixed by the Governor in Council pursuant to subsection (4).

Updated strategies to be tabled

(2) The appropriate Minister for the category I department shall cause the department's sustainable development strategy to be updated at least every three years and shall cause each updated strategy to be laid before the House of Commons on any of the next fifteen days on which that House is sitting after the strategy is updated.

Governor in Council direction

(3) The Governor in Council may, on that recommendation of the appropriate Minister for a department not named in Schedule I to the *Financial Administration Act*, direct that the requirements of subsections (1) and (2) apply in respect of the department.

Date fixed by Governor in Council

(4) On the recommendation of the appropriate Minister for a department that becomes a category I department after this subsection comes into force, the Governor in Council may, for the purpose of subsection (1), fix the day before which the sustainable development strategy of the department shall be laid before the House of Commons.

Regulations

(5) The Governor in Council may, on the recommendation of the Minister of the Environment, make regulations prescribing the form in which sustainable development strategies are to be prepared and the information required to be contained in them.

Schedule

(Section 2)

Atlantic Canada Opportunities Agency
Canada Revenue Agency
Canadian International Development Agency
Economic Development Agency of Canada for the Regions of Quebec
Parks Canada Agency

Appendix B Reports of the Standing Committee on Public Accounts to the House of Commons, 2005–06

The following reports have been tabled since our November 2005 Report went to print. They are available on the Web site of Canada's Parliament (www.parl.gc.ca).

38th Parliament, 1st Session

Report 20—Bill C-277: An Act to amend the *Auditor General Act* (audit of accounts) (presented to the House 5 October 2005; concurred in by the House 18 October 2005)

Report 21—Public Accounts of Canada 2005 (presented to the House 31 October 2005)

Report 22—Chapter 3, Passport Office—Passport Services of the April 2005 Report of the Auditor General of Canada (presented to the House 22 November 2005)

39th Parliament, 1st Session

Report 1—Public Accounts of Canada 2005 (presented to the House 17 May 2006)

Report 2—Chapter 3, Passport Office—Passport Services, of the April 2005 of the Auditor General of Canada Report (presented to the House 17 May 2006)

Report 3—Main Estimates 2006-2007: Vote number 20 under Finance (presented to the House 17 May 2006)

Report 4—Consideration of the Government response to the Tenth Report of the 38th Parliament (presented to the House 16 June 2006)

Report 5—2006–2007 Estimates and Performance of the Office of the Auditor General of Canada (presented to the House 16 June 2006)

Report 6—Chapter 5, Management of Programs for First Nations, of the May 2006 Report of the Auditor General of Canada (presented to the House 21 June 2006)

Report 7—Chapter 8, Canada Revenue Agency—Collection of Tax Debts, of the May 2006 Report of the Auditor General of Canada (presented to the House 21 June 2006)

Report 8—Chapter 7, Acquisition of Leased Office Space, of the May 2006 Report of the Auditor General of Canada (presented to the House 3 October 2006)

Appendix C Report on the audit of the President of the Treasury Board's report *Tabling of Crown Corporations Reports in Parliament*

Tablings in Parliament for parent Crown corporations: Annual reports and summaries of corporate plans and budgets

Section 152 of the *Financial Administration Act* requires the President of the Treasury Board to lay before each House of Parliament a report on the timing of the tabling, by appropriate ministers, of annual reports and summaries of corporate plans and of budgets of Crown corporations. The President of the Treasury Board's report on the timing of tablings is included in the 2006 *Annual Report to Parliament—Crown Corporations and Other Corporate Interests of Canada*, which must be tabled by 31 December.

The Act requires the Auditor General to audit the accuracy of the President of the Treasury Board's report on the timing of tablings and to present the results in her annual report to the House of Commons.

At the time that our annual report was going to print, we were unable to include the results of the above audit, since the President of the Treasury Board's report had not yet been finalized. The auditor's report, which is required by the Act, will therefore be included in the next Report of the Auditor General to the House of Commons. It will also be appended to this year's report of the President of the Treasury Board.

Appendix D Costs of Crown corporation audits conducted by the Office of the Auditor General of Canada

The Office is required under section 147 of the *Financial Administration Act* to disclose its costs incurred in preparing annual audit and special examination reports on Crown corporations.

An annual audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant. See Exhibit D.1 for the costs incurred.

A special examination determines whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that

- assets have been safeguarded and controlled;
- financial, human, and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

In 2005–06, the Office completed the special examination of eleven Crown corporations. The costs incurred were:

Canadian Broadcasting Corporation	$1,807,052
Canadian Dairy Commission	$514,653
Canadian Museum of Civilization Corporation	$878,522
Canadian Tourism Commission	$773,000
Cape Breton Growth Fund Corporation	$294,188
Laurentian Pilotage Authority	$389,070
National Gallery of Canada	$563,404
Old Port of Montreal Corporation Inc.	$637,540
Queens Quay West Land Corporation	$99,254
Ridley Terminals Inc.	$377,957
Royal Canadian Mint	$617,591

Exhibit D.1 Cost of preparing annual audit reports for fiscal years ending on or before 31 March 2006

Crown corporation	Fiscal year ended	Cost
Atlantic Pilotage Authority	31.12.05	$83,081
Atomic Energy of Canada Limited (joint auditor)	31.03.06	359,030*
Blue Water Bridge Authority	31.08.05	87,921
Business Development Bank of Canada (joint auditor)	31.03.06	498,529*
Canada Council for the Arts	31.03.06	151,262*
Canada Deposit Insurance Corporation	31.03.06	140,052*
Canada Development Investment Corporation (joint auditor)	31.12.05	99,037*
Canada Lands Company Limited (joint auditor)	31.03.06	230,647*
Canada Mortgage and Housing Corporation (joint auditor)	31.12.05	567,877*
Canadian Air Transport Security Authority	31.03.06	399,550*
Canadian Broadcasting Corporation	31.03.06	789,656*
Canadian Commercial Corporation	31.03.06	194,667*
Canadian Dairy Commission	31.07.05	106,660
Canadian Museum of Civilization	31.03.06	158,124*
Canadian Museum of Nature	31.03.06	127,546*
Canadian Tourism Commission	31.12.05	239,707*
Cape Breton Development Corporation	31.03.06	104,045*
Cape Breton Growth Fund Corporation	31.03.06	92,371*
Defence Construction (1951) Limited	31.03.06	57,386*
Enterprise Cape Breton Corporation	31.03.06	105,072*
Export Development Canada	31.12.05	930,631*
Farm Credit Canada	31.03.06	503,155*
Federal Bridge Corporation Limited, The	31.03.06	58,838*
Freshwater Fish Marketing Corporation	30.04.05	207,922
Great Lakes Pilotage Authority	31.12.05	121,160*
International Development Research Centre	31.03.06	140,312*
Jacques Cartier and Champlain Bridges Incorporated, The	31.03.06	96,769*
Laurentian Pilotage Authority	31.12.05	144,556*
Marine Atlantic Inc.	31.12.05	197,887
National Arts Centre	31.08.05	165,152
National Capital Commission	31.03.06	207,698*
National Gallery of Canada	31.03.06	118,053*
National Museum of Science and Technology	31.03.06	112,591*
Old Port of Montréal Corporation Inc.	31.03.06	206,383*
Pacific Pilotage Authority	31.12.05	50,689
Parc Downsview Park Inc.	31.03.06	105,455*
Queens Quay West Land Corporation	31.03.06	33,755*
Ridley Terminals Inc.	31.12.05	92,240*
Royal Canadian Mint	31.12.05	404,660
Seaway International Bridge Corporation Limited, The	31.03.06	57,486*

Exhibit D.1 Cost of preparing annual audit reports for fiscal years ending on or before 31 March 2006

Crown corporation	Fiscal year ended	Cost
Standards Council of Canada	31.03.06	53,223*
Telefilm Canada	31.03.06	196,393*
VIA Rail Canada Inc. (joint auditor)	31.12.05	352,958*

*Preliminary costs subject to year-end adjustments

Report of the Auditor General of Canada to the House of Commons—November 2006

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Government
Publications

2006



Report of the
Auditor General of Canada
to the House of Commons

NOVEMBER

An Overview of the Federal Government's Expenditure Management System

Chapter 1
Expenditure Management System at the Government Centre

Chapter 2
Expenditure Management System in Departments

Office of the Auditor General of Canada



2006



Report of the

Auditor General of Canada

to the House of Commons

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An Overview of the Federal Government's Expenditure Management System

Chapter 1
Expenditure Management System at the Government Centre

Chapter 2
Expenditure Management System in Departments

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents for the Report is found at the end of this publication.



The Report is available on our website at www.oag-bvg.gc.ca.

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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-2E
ISBN 0-662-44366-7

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An Overview of the Federal Government's Expenditure Management System

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An Overview of the Federal Government's Expenditure Management System

Introduction

1. Demands on government are unlimited, but the resources available to meet them are not. Governments must therefore have some means of deciding how much they can afford to spend, what to spend it on, and how to get the most for the money spent. The policies, processes, and practices they follow to deal with these questions constitute the Expenditure Management System (EMS).

2. The EMS is at the heart of the operation of government. It touches everything the government does, since all government activities involve spending. A system that works well promotes efficient, responsive, and accountable government. If it does not, nothing that departments and agencies do individually will yield sound overall management of government spending. An effective EMS is therefore essential to getting the results the government wants and accounting to Canadians for what is done on their behalf.

3. The EMS in the federal government has evolved considerably over the years, with countless variations in the way the government plans, manages, and reports on its spending. This chapter looks at the system as it appears today. Exhibit 1 outlines the main objectives, inputs, and players of the EMS.

4. In its first budget released on 2 May 2006, the new government announced that it is seeking

> a new ongoing approach to managing overall spending to ensure that all government programs are effective and efficient, are focused on results, provide value for taxpayers' money and are aligned with the Government's priorities and responsibilities.

Recent spending patterns and trends

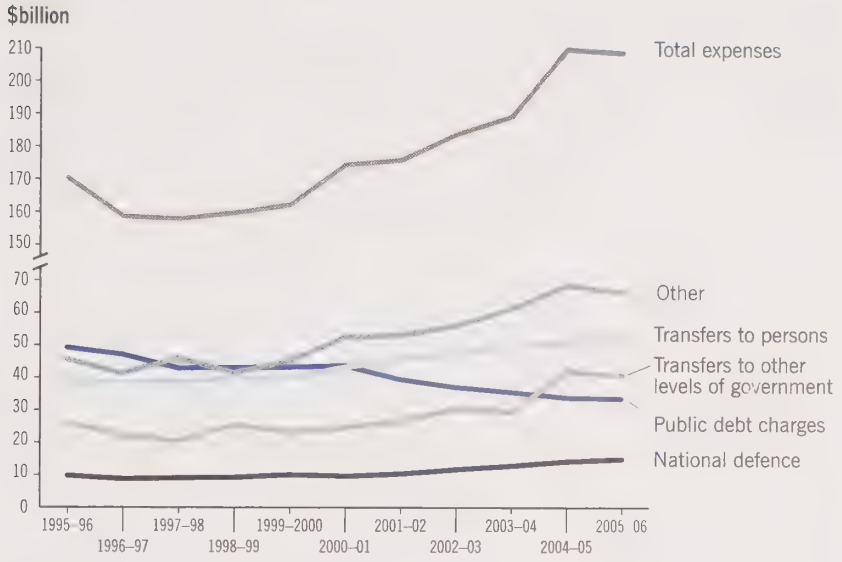
5. In the last half of the 1990s, federal spending fell and then remained more or less flat as the government strained to bring the budget deficit under control. Spending then grew steadily, from $162 billion in 1999–2000 to $210 billion in 2004–05 (Exhibit 2). It fell marginally in 2005–06, to $209 billion, owing largely to the dissolution of Parliament, which prevented some planned spending from receiving parliamentary authority to proceed.

6. With the declining debt and lower interest rates, debt service charges have fallen steadily from nearly 30 percent of federal spending in the mid-1990s to just over 16 percent in 2005–06. This shift was the most conspicuous change in the composition of federal spending over the past decade. Among other spending categories, transfers to other levels of government lagged during the 1990s, but they experienced the fastest growth more recently. As a result, the relative distribution of program spending (spending other than debt services charges) in 2005–06 was similar to that of 10 years earlier.

Exhibit 1 The main objectives, inputs, and players of the Expenditure Management System

Basic objectives	Main inputs	Key players
Overall fiscal control	• Fiscal strategy • Spending and revenue forecasts • Budget preparation	• The Cabinet • The Department of Finance
Efficient allocation of resources	• Priority setting • Policy development • New spending approvals • Production of Estimates	• The Cabinet • The Privy Council Office • The Department of Finance • The Treasury Board and its Secretariat • The departments
Operational efficiency	• Operational planning • Financial management and controls • Performance monitoring and measurement	• The Treasury Board and its Secretariat • The departments
Parliamentary control	• Examination and approval of the Estimates • Review of Public Accounts and program performance	• The House of Commons • Parliamentary committees • The Auditor General

Exhibit 2 Federal government spending by major purpose



Source: *Public Accounts of Canada*

Setting of limits on total spending

7. To manage public spending effectively, any government needs to exercise fiscal discipline—to establish what it can afford to spend and to live within those limits. Establishing those limits is a key purpose of the annual budget.

What the annual budget is and what it does

8. The annual budget is a financial expression of the government's priorities, policies, and plans. Historically, the budget was released after the presentation of the Main Estimates, which lay out the detailed spending plans of the government. The budget therefore focused chiefly on the "ways and means"—the taxes and other measures needed to fund the government's plans. Over the past two decades, the budget evolved into the main vehicle for announcing new spending initiatives as well as tax measures. It has no legal authority; although measures announced in the budget may take effect immediately, they must be presented for Parliament's approval in separate legislative proposals before they become law.

9. The budget does three things:

- reviews recent economic developments and the current economic outlook;
- announces new spending initiatives and tax changes; and
- establishes the government's Fiscal Plan, showing how much revenue the government expects to collect over its planning period, how much it intends to spend, and the resulting balance and level of debt.

10. In developing its Fiscal Plan, the government establishes a ceiling on its total spending. The key factor that shapes the Fiscal Plan is the budget balance: the government's current stated objective is to maintain a surplus of $3 billion each year. All decisions on taxing and spending must line up with this objective.

11. The government's first step in budget planning, then, is to determine how much it can spend without putting this budget balance at risk. The Department of Finance, which develops the Fiscal Plan, makes projections of revenues and expenses under present policies and expected economic conditions. It reduces the resulting balance by the $3 billion planned as the surplus. The residual left after these calculations is the amount available for new spending or tax cuts, depending on an assessment of their relative benefits and on the government's priorities.

12. Exhibit 3 shows the Fiscal Plan from the most recent budget, tabled in May 2006. It shows that, after the $3 billion set aside as the target surplus, the remaining surplus of $0.6 billion in 2006–07 and $1.4 billion in 2007–08 would be available to fund future priorities.

How the budget is prepared

13. Budget-making is a year-round process involving regular reviews of economic and fiscal developments, program requirements, and policy priorities.

14. **June to October.** The Cabinet holds retreats in early summer and fall to review policies, discuss priorities, and develop a budget strategy and themes. The Privy Council Office (PCO) provides background information on recent developments that could have implications for the agenda set out in the government's election platforms and the most recent Speech from the Throne. The Department of Finance updates the fiscal outlook and discusses fiscal options in light of current economic conditions and the government's objectives.

Exhibit 3 Budget 2006 Fiscal Plan

	Actual 2004–05	Estimate 2005–06	Projections	
			2006–07	2007–08
Budgetary transactions	($ billions)			
Budgetary revenues	**211.9**	**220.9**	**227.1**	**235.8**
Program expenses	176.3	179.2	188.8	196.5
Public debt charges	34.1	33.7	34.8	34.8
Total expenses	**210.5**	**212.9**	**223.6**	**231.4**
Budgetary balance	**1.5**	**8.0**	**3.6**	**4.4**
Planned surplus			**3.0**	**3.0**
Unallocated surplus			**0.6**	**1.4**
Federal debt	**494.4**	**486.4**	**483.4**	**480.4**

Note: Totals may not add due to rounding.

The government's Fiscal Plan shows how much revenue the government expects to collect over its planning period, how much it intends to spend, and the resulting balance and level of debt.

Source: Department of Finance, *The Budget Plan 2006,* Table 4.4.

15. **October to November.** Extensive consultations begin formally in the fall with the presentation of the *Fiscal and Economic Update*. The Update is delivered by the Minister of Finance to the House of Commons Standing Committee on Finance. It reviews fiscal results since the previous budget and revises the fiscal outlook in light of recent economic conditions.

16. **September to December.** The House of Commons Finance Committee invites submissions from the public and holds hearings on priorities and issues for the upcoming budget. It reports with recommendations to Parliament in December. The Minister of Finance and the Department also consult with individuals, interested groups, and organizations about the forthcoming budget.

17. **December to February.** Drawing on these consultations and on recommendations from the Cabinet policy committees, the Minister of Finance develops a proposed budget strategy for review by the Cabinet.

Early in the year, the Minister of Finance and the Prime Minister take final decisions on the budget, based on the latest fiscal outlook and the government's priorities. The Minister of Finance presents the budget in the House of Commons, usually in mid-February and normally on a Tuesday afternoon, after financial markets have closed.

18. The House debates the budget for an additional four days (not necessarily consecutively). At the end of the debate, it votes on a motion by the Minister of Finance to approve the government's budgetary policy. While approving the motion confers no legal authority on the budget measures, defeat of the motion constitutes a vote of no confidence that spells the defeat of the government. This has happened only twice in Canada's history, in May 1974 and December 1979.

19. With the presentation of the budget, the Minister of Finance also tables notices of ways and means motions that detail the tax changes proposed in the budget. In time, these proposals will be incorporated in tax bills and steered through the normal process for passing legislation.

20. New spending proposals receive funding approval either through the supply process (see the role of Parliament on page 18), budget implementation acts, or specific legislative measures, which follow the same process as other legislative proposals by the government.

The budget's spending framework

21. Since 2003, budgets show expenses on an accrual basis—revenues and expenses are recorded when the associated activity occurs, not when the government receives or pays out cash. Budget 2006 abandoned the practice of subtracting expenses against associated revenues ("netting"), and instead showed figures on a gross basis. Our Office had expressed concerns about netting because it does not accurately reflect the nature and size of government. This change increased the government's reported expenses by $13.8 billion. It had no impact on the budget balance, since reported revenues increased by the same amount.

22. The Budget breaks down total spending into public debt charges (interest payments on the public debt) and program expenses. The program expenses are split about evenly between transfer payments and direct program expenses (Exhibit 4).

23. Transfer payments consist of transfers to persons and to other levels of government. Transfer payments to persons include payments to individuals for old age security, employment insurance, and child benefits. Transfers to governments are payments to the provinces and the territories, primarily for health care, equalization, and social assistance.

24. Direct program expenses include wages, salaries, and other operating costs; grants and contributions to various groups and organizations; and payments to Crown corporations. They also include amounts set aside for specific purposes, but for which precise allocations have not yet been established at budget time.

Exhibit 4 How the Budget breaks down government expenses

	Actual 2004–05	Estimate 2005–06	Projections	
			2006–07	2007–08
	($ billions)			
Transfers to persons	51.3	53.2	56.3	59.0
Transfers to governments	42.0	40.8	40.1	41.1
Total transfers	93.3	94.0	96.4	100.1
Direct program expenses	83.1	85.2	92.4	96.5
Total program expenses	176.3	179.2	188.8	196.5
Public debt charges	34.1	33.7	34.8	34.8
Total spending	**210.5**	**212.9**	**223.6**	**231.4**

Note: Totals may not add due to rounding.

Source: Department of Finance, *The Budget Plan 2006*

Allocation of funds to programs

25. Government spending programs include programs for which funding is governed by continuing statutory authority (legislation) and programs that depend on annual appropriations. Amendments to statutory programs require legislative changes. Their existence and level of funding are therefore not challenged as part of the annual budget cycle. Non-statutory programs need to be reauthorized each year, and their funding is therefore always subject to change. In practice, a combination of entrenched commitments, the cost of change, and the allure of stability for planning purposes affords non-statutory programs substantial immunity from spending cuts in normal circumstances. Budget decisions usually deal with allocating new funds among competing priorities, not reallocating the present funding of ongoing programs. Under Canada's current budget process, new spending is approved on a separate track from ongoing spending.

Approval of spending on existing programs

Reference levels—The amount of funding that the Treasury Board has approved for departments and agencies to carry out approved policies and programs for each year of the planning period.

26. The Treasury Board allocates funding for the ongoing delivery of existing programs through a process known as the Annual Reference Level Update (ARLU). In early summer, the Treasury Board Secretariat issues a letter telling departments to update their budgets ("**reference levels**") for the upcoming fiscal year and the two following planning years. Departments adjust their reference levels to incorporate new spending approved since the previous ARLU review and to reflect certain factors such as the impact of collective agreements, "reprofiling" of funds (shifting funds from one year to another), items whose authorized funding period has ended, and revised spending forecasts for statutory programs.

27. The updated reference levels are submitted to the Secretariat in the fall, usually in October. About 125 such submissions are made every year. After reviewing them for accuracy and compliance with requirements, the Secretariat reports its assessment to the Treasury Board. The Board usually considers and approves this report by mid-December.

28. The Treasury Board Secretariat describes the ARLU process as "primarily a technical exercise that updates departmental funding for the next year as well as the two years after that." The reference levels approved by the Treasury Board form the basis for developing both the Main Estimates used to seek Parliament's approval of departmental spending for the next fiscal year and the expenditure plan presented in the annual budget.

Fiscal framework—The framework within which the Government makes fiscal decisions. It shows projected expenses and revenues and the financial resources available for new initiatives, given the Government's objectives about the deficit and debt.

29. In addition to approving the updated reference levels, the Treasury Board may allocate resources from reserves set aside in the **fiscal framework** for certain purposes tied to the Board's expenditure management responsibilities. Examples include urgent issues affecting public safety or the integrity of an existing program, investments to improve the efficiency of existing programs, and additional costs resulting from collective agreements.

Approval of new spending

30. Proposals that involve spending for new initiatives or for enrichments to existing programs can take one of two paths, depending on whether they originate in departments or the government centre. Spending proposals that originate in the government centre normally entail initiatives that straddle a number of departments. Proposals affecting single departments are normally initiated by those departments.

Spending proposals originating in departments

31. Ministers seeking new funds—whether to respond to rising demands in their portfolio, improve levels of service, or fund a new initiative—must first submit a request to the appropriate policy committee of the Cabinet. Under the current government there are three policy committees: Social Affairs, Economic Affairs, and Foreign Affairs and National Security.

32. The instrument by which funding is requested is a Memorandum to Cabinet (MC). The memorandum presents the proposal, the reasons for it, its possible impacts, and the financial implications. The memorandum need not identify a source of funds; at this point, it is policy approval or approval in principle that is sought.

33. The Cabinet committees review proposals and decide whether to approve them. Spending proposals approved by a Cabinet committee are referred for ratification to the Cabinet's Priorities and Planning Committee, which is chaired by the Prime Minister, or to the full Cabinet.

34. Following Cabinet ratification, spending proposals are added to an inventory of possible initiatives for future budgets. The Minister of Finance and the Prime Minister decide which proposals will be included in the Budget, depending on available funding and priorities not yet addressed.

35. Once an initiative has been included in the Budget, the sponsoring minister makes a separate submission to the Treasury Board to request that funds be allocated. The submission to the Treasury Board explains how the department will carry out the proposed initiative and with what resources each year, what the department expects the initiative to achieve, and how it will monitor and assess results. The Treasury Board may reject a submission (an extremely rare occurrence), approve it outright, or approve it with conditions. If the funding approved relates to an ongoing new initiative or a permanent expansion of an existing program, the funding becomes part of the relevant department's reference level and gets on the spending track for ongoing programs.

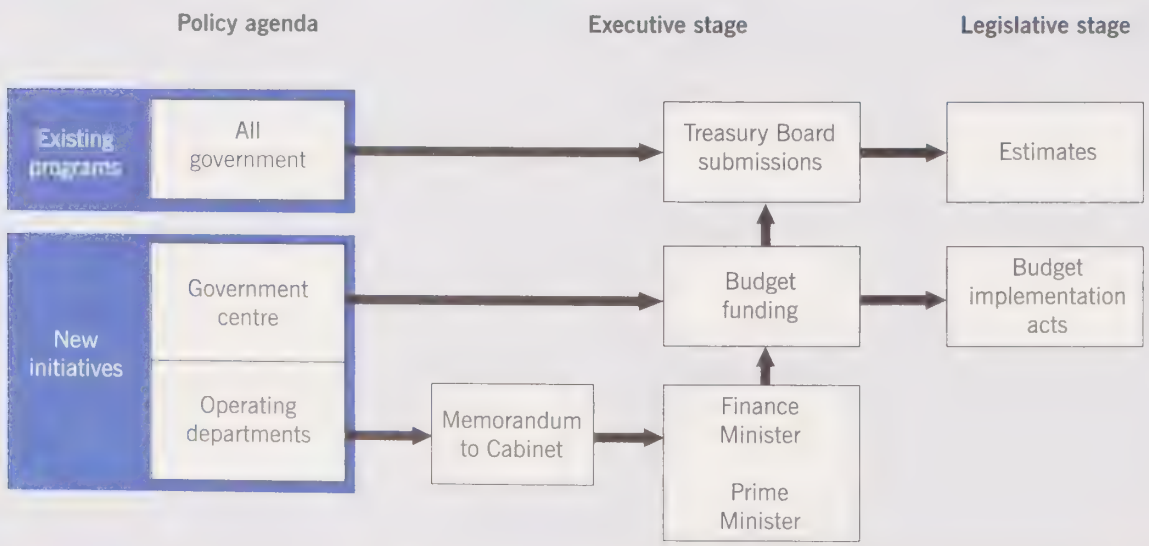
Spending proposals originating in the government centre

36. The process of allocating funds for new initiatives does not always originate with spending proposals by government departments. Departmental proposals often follow decisions already made at the centre of government—by the Cabinet, the Prime Minister, or the

Minister of Finance—to increase funding in a particular policy area. These decisions are usually announced at budget time, but they can also be made outside the regular budget process. An example of the latter is the government decision announced last fall to allocate $2.4 billion over the following five years to cushion the impact of energy-cost increases on low-income families and to encourage energy conservation efforts. When a decision is made to fund an initiative, funds are notionally set aside in the fiscal framework for the appropriate departments. The departments then submit proposals to the Treasury Board for allocations from the earmarked funds, based on specific program design and implementation details.

37. A point to note from the above description is that specific allocations to departments require Treasury Board approval. Funding requests for existing programs are approved by the Treasury Board alone; allocations for new policies or enrichments need to first receive policy approval by the Cabinet and to have a source of funds identified. They then receive legislative authority through the Estimates process. In some cases, spending initiatives formulated in the Budget receive legislative approval directly through a budget implementation act, bypassing the TB submission and Estimates process (Exhibit 5).

Exhibit 5 How the government allocates funds to deliver on its priorities



Promotion of efficient management of resources

38. Delivering public services efficiently while complying with authority and the requirements of due process is the joint responsibility of departments and the Treasury Board and its Secretariat. Departmental statutes and the *Financial Administration Act* make ministers responsible for maintaining control over spending in their departments, but the Secretariat has a central role in promoting good management practices and in ensuring that departmental operations are consistent with the government's priorities and meet its standards for efficiency and probity.

The policy framework

39. The *Financial Administration Act* authorizes the Treasury Board to act on all issues of administrative policy, financial management, spending and estimates, human resources management, and any other matters that administering the federal public sector entails. In effect, the Treasury Board acts as the government's "management board" and was officially designated as such in June 1997.

40. The Treasury Board performs two main functions as a management board: It sets management policies and standards for departments, and it oversees departments' compliance with them.

41. Some high-profile failures of departmental management in recent years have generated stronger oversight from the government centre, but the general trend over the past four decades has been toward less intrusion and involvement by central agencies in the decisions and activities of departments. The purpose of this change is to give departmental managers the flexibility to manage their departments in ways that improve performance. The shift is reflected in the declining numbers of submissions received annually by the Treasury Board, from some 16,000 in the early 1960s to 1,850 in the early 1990s, and under 1,000 today.

42. With this change comes the need for appropriate mechanisms to hold managers accountable for their use of resources. The Treasury Board has explored various mechanisms for this purpose over the years, and it currently uses a set of expectations for public service management under an initiative called the Management Accountability Framework.

43. Introduced in 2003, the Management Accountability Framework consists of 10 "essential elements of sound management" (Exhibit 6), with indicators and measures of performance for each. It was developed not only as an instrument for holding departmental managers accountable for delivering on agreed objectives, but also as a means for departments to assess their own performance and report on it. The Management Accountability Framework is also expected eventually to inform Treasury Board decisions on resource allocation, but at present it is not part of the budget process.

44. Another recent initiative shaping the way the government manages and reports what it does is the Management Resources and Results Structure. The Management Resources and Results Structure has three components: strategic outcomes, programs aimed at achieving those outcomes, and information on the resources and performance of each of the programs. All departments are required to organize their operations within the framework of the Management Resources and Results Structure to provide for a common approach to collecting and reporting information across the whole government.

45. The Management Resources and Results Structure is supported by the proposed new Expenditure Management Information System, an electronic database intended to link spending to results on a common basis government-wide. Timely, reliable information on what government programs cost and what they achieve is necessary for effective resource management, accountability, and oversight. It does not yet exist across all of the government.

Exhibit 6 Elements of the Management Accountability Framework

The elements of the Management Accountability Framework are

- public service values;
- governance and strategic directions;
- results and performance;
- learning, innovation, and change management;
- policy and programs;
- risk management;
- people;
- stewardship;
- citizen focused service; and
- accountability.

Departmental functions

46. Departments have the primary responsibility for managing the resources allocated to them and delivering the results they committed to deliver. Departmental statutes explicitly assign to ministers responsibility for the "direction and management" of their departments. The *Financial Administration Act* also assigns to ministers and their deputies additional, more specific responsibilities for prudent management of resources allocated to their departments.

47. These additional responsibilities include requirements that govern payments made from the Consolidated Revenue Fund, including the requirement to maintain records of financial commitments and to ensure that payments

- do not exceed funds appropriated for the purpose by Parliament;
- are requisitioned by a minister or authorized officer in a form prescribed by the Treasury Board; and
- are made only after the departmental officer responsible certifies that performance conditions were met if the payments are for services or goods received, or that the recipient is entitled to the payment if it is a grant or a contribution.

48. These basic legal requirements are designed to ensure that spending complies with parliamentary appropriations and that funds are not diverted to unauthorized uses. Departments are also expected to have appropriate management systems and processes to promote the efficient and effective use of funds.

49. Within the budgets voted by Parliament and the policies and limits issued by the Treasury Board, departments are free to decide on the appropriate mix of resources that will deliver their programs cost-effectively. They set objectives and allocate resources to achieve them, establish controls to ensure that decisions are implemented as intended, monitor performance, and maintain financial accounts and records. As part of their planning, they assess risks to and pressures on their programs and adjust their operations to manage them. When they determine that they need additional resources, they prepare submissions to the Cabinet and the Treasury Board for approval of funding.

The role of Parliament

50. Parliamentary control of the public purse is fundamental to responsible government. Granting government the authority to spend is one of Parliament's principal functions and is a key part of holding the government to account. Parliament's power to grant this authority is founded on two basic principles:

- The government may not raise money without Parliament's approval.
- The government may not spend money except for purposes authorized by Parliament.

51. These principles were already well established at the time of Confederation and were incorporated in the *Constitution Act, 1867*. To support parliamentary control of public money, the Constitution directs that all "duties and revenues" shall be paid into one Consolidated Revenue Fund, and all payments made from the Fund must be appropriated by Parliament.

52. Parliamentary authority to spend is granted through a process known as the Business of Supply. Rules governing the process are codified in the Constitution, statutes (primarily the *Financial Administration Act*), and the Standing Orders of the House of Commons. Grounded in centuries of parliamentary tradition, these rules are intended to ensure that parliamentarians have adequate opportunity to scrutinize and debate the government's spending proposals before they approve them.

Form and content of the Estimates

53. The Constitution specifies that all spending measures must be initiated by the Crown—that is, the executive—and must originate in the House of Commons. In other words, it is the job of the government to prepare a spending plan and bring it to the House. The government presents this plan in the form of the Estimates.

54. Currently, the Estimates are structured in three parts:

- Part I, The Government Expense Plan, provides an overview of projected federal spending for the fiscal year and relates the Estimates to the planned spending presented in the budget.
- Part II, The Main Estimates, provides details of proposed spending by department and program, in a form that Parliament will be asked to approve in order that the government may proceed with its spending plans.

- Part III, departmental expenditure plans have, since 1997, been split into
  - reports on plans and priorities (RPPs), which present more detailed information on what departments do and plan to do over the next three years (based on their strategic plans); and
  - departmental performance reports, which report the results achieved against the plans set out in previous RPPs.

55. The Estimates include statutory and non-statutory—voted—expenditures. Statutory expenditures are those that have already been authorized by legislation; they are presented in the Estimates for information purposes only. Statutory expenditures today account for about two thirds of total federal spending.

56. Voted expenditures are those for which the government must seek Parliament's approval annually. These expenditures are set out in "votes" for each department and agency. A vote is an individual item in the Estimates indicating the amount of funds required by the government for a particular activity or program. The most common types of vote are the following:

- Capital expenditures—used when capital spending equals or exceeds $5 million.
- Grants and contributions—used when spending on grants and contributions equals or exceeds $5 million.
- Operating expenditures—used for other than capital spending or grants and contributions, when spending amounts for capital or grants and contributions are large enough (over $5 million) to be listed under a separate vote.
- Program expenditures—used when neither capital spending nor grants and contributions exceeds $5 million. In that case, all expenditures are charged to this one vote.
- Non-budgetary—used for spending in the form of loans and investments. This type of spending does not affect the budget balance (because each payment generates a corresponding asset), but it still requires parliamentary approval.

57. Most departments and agencies have only one vote, a program expenditures vote. Some 20 larger departments have several votes.

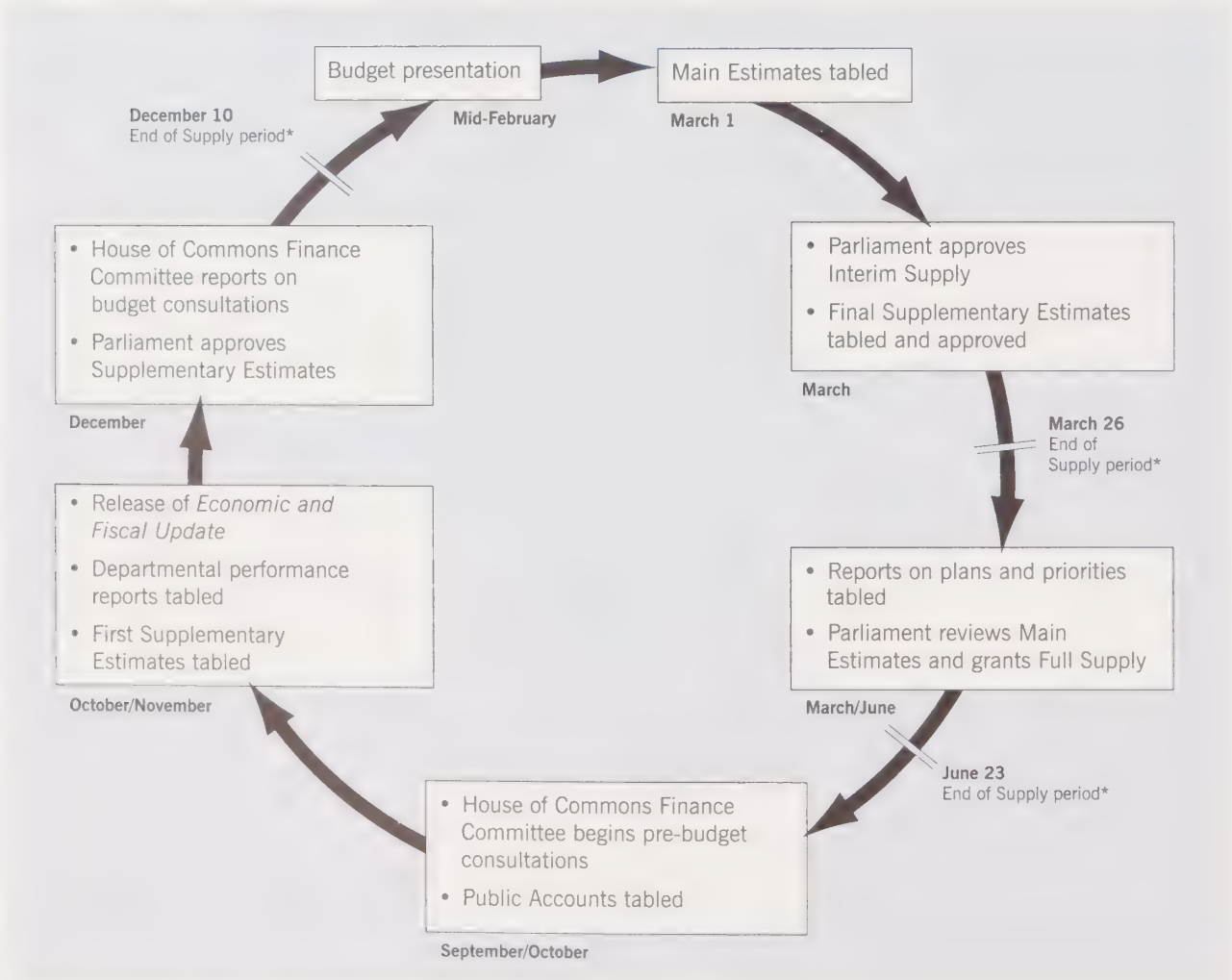
58. Once approved by Parliament, the wording of the vote and the specified amounts become the conditions under which the government

may spend. The amounts in the vote establish a maximum amount that may be spent—they do not represent a commitment to spend the full amount.

The parliamentary calendar

59. The present rules of the House divide the parliamentary calendar into three Supply periods, during which 22 days are allocated to the Business of Supply: there are 7 days in the period ending December 10, 7 days in the period ending March 26, and 8 days in the period ending June 23 (Exhibit 7). On the allotted days, members in opposition to the government may propose motions for debate on any matter falling within the jurisdiction of the Parliament of Canada, as well as on committee reports concerning the Estimates.

Exhibit 7 Parliamentary financial cycle



*Latest date by which House of Commons must concur in Estimates and approve the associated appropriation act

60. The Main Estimates must be tabled in the House of Commons no later than March 1. They are tabled the same day or the next sitting day in the Senate. Reports on plans and priorities are tabled later in the spring, and performance reports in the fall.

61. Once tabled, the Main Estimates are referred to the various standing committees of the House of Commons, by subject matter, and to the Senate Standing Committee on National Finance. Estimates for programs delivered by more than one department or agency are normally referred to the House of Commons Standing Committee on Government Operations and Estimates. House committees have until May 31 to review the Main Estimates and report back to the House; if they do not, the Main Estimates are deemed to have been reported.

62. In considering the Main Estimates, committees may approve, reduce, or "negative" (not approve) a vote. A committee may not increase the amount of a vote or change or redirect the funds involved, since that would infringe on the constitutionally prescribed financial initiative of the Crown.

63. The Main Estimates, as reported by the standing committees or as deemed reported, must go through several more stages before the government is considered to have authority to spend. Under normal circumstances, on the last allotted day in the Supply period ending June 23, the House votes on a motion to concur in Main Estimates. Following this motion, an appropriation bill incorporating the Main Estimates is introduced and must be approved by the House of Commons. The bill is then sent to the Senate, where it must also pass. Once the bill is passed by both Houses, it receives Royal Assent and becomes law. Only then is the government authorized to make withdrawals from the Consolidated Revenue Fund, up to the limits set in the Main Estimates and for the purposes specified in the votes.

64. Spending authority lapses at the end of each fiscal year for all departments and agencies, except Parks Canada, the Canada Revenue Agency, and the Canada Border Services Agency, which are authorized by legislation to carry unspent funds into the following year. To encourage good cash management practices, other departments and agencies are also allowed to carry forward unused appropriations up to five percent of their operating and capital budgets, but these require Parliament's approval annually. Funds carried over are accessed through the use of Supplementary Estimates in the following fiscal year.

Interim Supply

65. The government's fiscal year begins April 1. Normally, the Main Estimates are not approved until late June. So it can continue to operate in the meantime, the government requests "Interim Supply" by the end of March. A vote to concur in Interim Supply occurs on the last allotted day in the Supply period ending March 26. The amount granted is usually 3/12 of each vote in the Main Estimates. As with the Main Estimates, the granting of Interim Supply also requires that an appropriation bill be passed.

Supplementary Estimates

66. During the fiscal year, there will inevitably be calls on public funds that were not anticipated or for which the precise allocation had not been decided when the Main Estimates were put together in the fall of the previous year. The government seeks authority for these new demands through Supplementary Estimates, which are also used to transfer funds between votes and to write off debts or adjust loan guarantees. Supplementary Estimates are usually tabled twice a year, in the late fall and in March, though they can be tabled more often if necessary. They are referred to various committees and deemed reported back to the House three sitting days before the final sitting or the last allotted day in the Supply period. Motions to concur in the Supplementary Estimates take place on the last allotted day in the Supply period.

67. The traditional purpose of the Supplementary Estimates is to finance unanticipated spending by the government. In recent years, however, they have become a vehicle for new spending and programs announced outside the normal budget cycle. During the fiscal years from 1997–98 to 2004–05, supplementary appropriations averaged 10.5 percent of the total appropriations, up from an average 4.5 percent in the previous eight years.

Governor General special warrants

68. Special warrants are instruments that authorize government spending without prior legislative approval. The *Financial Administration Act* (FAA) establishes specific conditions that must be met before special warrants will be issued:

- A special warrant can only be issued if Parliament has been dissolved.
- A minister must report that a payment is urgently required for the public good.
- The President of the Treasury Board must report that there is no other appropriation for the payment.

69. Special warrants may only be issued from the date of dissolution of Parliament until 60 days following the date fixed for the return of the writs after a general election. The FAA further requires that every special warrant be published in the *Canada Gazette* within 30 days after it is issued. Within 15 days of Parliament's return, the President of the Treasury Board must table a statement in the House of Commons showing all warrants issued while Parliament was not sitting. Retroactive legislative approval is provided in the first appropriation bill passed in the new Parliament.

70. While the last Parliament was dissolved, the Governor General issued four special warrants for a total of $15.6 billion.

Reporting and audit

71. Departments gain access to funds appropriated by Parliament by submitting requisitions to the Receiver General for Canada, who is responsible for administering the Consolidated Revenue Fund. Departments are required to maintain detailed accounts of the payments they make and to reconcile them monthly with the central, or control, accounts of the Receiver General. The individual accounts of departments are rolled up into the accounts of Canada. Together with other records that departments maintain, these accounts are the source of information used to prepare the *Public Accounts of Canada*—the government's annual report on how it has spent the funds appropriated by Parliament.

72. By law, the Public Accounts must be tabled in the House of Commons within nine months of the end of the fiscal year to which they relate. In practice, they are usually tabled in early fall. They are produced in three volumes:

- Volume I contains the summary financial statements of Canada, as well as discussion and analysis of the government's finances, including a 10-year comparison of financial data.
- Volume II presents financial operations by ministry.
- Volume III provides additional information required by the *Financial Administration Act*, such as the financial statements of revolving funds, spending on professional and special services, real estate acquisitions, transfer payments, and public debt charges.

73. The Auditor General of Canada examines the summary financial statements included in the Public Accounts to determine whether they are presented fairly in accordance with the government's stated accounting policies, which conform with Canadian generally accepted accounting principles. The Auditor General's opinion and

observations are included in Volume I of the Public Accounts. The Office of the Auditor General also examines operations and programs in departments and reports to Parliament whether they are run economically and efficiently and whether the government has the means to measure their effectiveness.

74. The *Public Accounts of Canada* and the Auditor General's reports are referred to the House of Commons Standing Committee on Public Accounts for review. The Committee's mandate is to ensure that public money is spent for the purposes authorized by Parliament. The Committee holds hearings at which officials from both the Office of the Auditor General and audited departments appear to answer questions about the reported audit findings. Other parliamentary committees also hold hearings on the audit reports that cover areas within their mandate. After its hearings, a committee may report to the House and recommend action the government should take. The audited departments are generally expected to report back to the committee on what they have done in response to these recommendations. Committees have the right to ask government to respond to their recommendations in writing within 120 days.

Inherent tensions in management of public spending

75. As already noted, the federal government over the years has considerably changed the way it organizes and carries out its expenditure management functions. This is not surprising: as conditions affecting public spending and the government's capacity to deal with them change, the systems for managing public spending would be expected to change as well. For example, a system suited to times of fiscal stress is not necessarily the best one for periods of fiscal abundance. Changes in the scale and nature of government spending will call for corresponding changes in how spending is managed. Advances in computing and communications create new capacities to monitor performance and coordinate activities, which may favour new approaches to managing spending. For all these reasons, a system as large and complex as Canada's Expenditure Management System is almost constantly changing.

76. Certain issues persist, however, through all variations of the EMS. They remain perennial challenges to every EMS, because they are tensions inherent in the functions that every EMS serves. They include the following:

- linking priority setting with resource allocation,

- balancing central control with management flexibility for departments, and
- accommodating ongoing review of spending with predictable funding.

Linking priority setting with resource allocation

77. A basic requirement of any EMS is that it support the government in setting priorities and allocating resources to achieve them. To a significant extent, these are political tasks, governed largely by the values and preferences of the principals involved. There is no fully objective way to set priorities and allocate resources. Nevertheless, the information that decision makers have and the process they use affect the outcome of their decisions. It helps therefore to have a process that promotes careful consideration of spending options and sound information on the costs and benefits of alternatives, including information on long-term costs and the sustainability of funding.

78. The key element in that process is ensuring that decisions on resource allocation are made within a framework of affordable spending limits. In the absence of limits, decision makers could adopt policies and approve programs without taking into account the costs of their decisions—when money is no object, everything can be done. Budgeting within spending limits, however, forces decision makers to recognize that resources are limited and every program has to compete for them. It encourages careful review of spending proposals and comparison of their merits with what must be given up to adopt them.

79. An effective EMS should also enable the government to reallocate resources from less-valued uses to more-valued ones when needs and priorities change. To do this, the government needs the capacity not only to compare and choose from among new spending initiatives, but also to transfer resources from existing programs. New spending accounts for a small fraction of total spending in any year, usually much less than 10 percent. Significant reallocation is thus impossible without transfers from existing programs.

80. Reallocation from existing programs is often difficult, protected as they are by inertia, past commitments, and vested interests. In any case, it would be costly and impractical to scrutinize all ongoing programs from top to bottom as part of the annual budget allocation process. However, it is a good practice to compare new spending proposals with related existing programs and explore possible synergies and trade-offs among them. It is also feasible and useful to review all programs periodically and assess how efficient, effective, and relevant

they are. Resources cannot be channelled to new priorities if, once established, programs are immune to cutbacks.

81. It is precisely because ongoing programs are difficult to change once in place that new proposals need to be reviewed and challenged rigorously before they are adopted. Central agencies need to ensure that the financial implications of proposals have been thoroughly assessed, alternative options have been considered and their relative risks identified, and expected results are clearly specified so that ongoing performance can be measured and monitored.

82. In sum, strategies that promote the integration of priority setting with resource allocation include

- setting spending caps on broad policy areas to encourage reallocation in meeting new demands for spending;
- systematic, regular review of spending programs to determine whether they are effective and still relevant; and
- rigorous review and costing of new spending proposals, within a framework that encompasses spending on existing programs.

Balancing central control with management flexibility for departments

83. When the Royal Commission on Government Organization (the "Glassco Commission") examined the organization of the federal government in the early 1960s, departments were the main vehicles of service delivery as they are today, but they had very little autonomy to decide how to manage what they did. Spending estimates itemized in great detail how departments were to spend the money allotted to them, and the Comptroller of the Treasury had to approve all payments before they were made. The Glassco Commission concluded that this way of managing the public service was dysfunctional, and it recommended that significant authority be delegated to departments to "let the managers manage."

84. The Commission was also clear that this delegation had to take place within a framework that protected the need of the government for unity and proper regard for the general interest of Canadians. In the words of the Commission:

> Above all, departments should, within clearly defined terms of reference, be fully accountable for the organization and execution of their programmes, and enjoy powers commensurate with their accountability. They must be subject to controls designed to protect those general interests of government which transcend departmental interests. But every department should be free of external controls which have no such purpose.

85. Delegating authority to departments makes their managers more directly responsible for the results of their programs. It both enables and encourages managers to use their knowledge and judgment to manage the resources under their control more efficiently. But as Glassco stressed, money allocated to departments is not departmental but "public money," and the government collectively is responsible to Parliament and the public for its proper use. An effective expenditure management framework must seek to satisfy simultaneously the government centre's need for enough control to provide overall direction and departments' need for enough autonomy to operate efficiently.

86. More specifically, the government centre must be able to set policies and provide guidance to departments to ensure that they operate in line with government priorities, comply with authorities in their spending, and give due regard to efficiency and effectiveness. It must also oversee departments and hold them accountable for their performance. This requires that clear expectations and measures of performance be established before spending authority is granted.

87. Departments, in turn, must be able to manage their operations within the policies and standards set from the government centre. They must understand those standards and have controls to ensure that they are met. Both the centre and departments need to have their respective responsibilities clearly specified and reliable information available on costs and performance to aid their decisions.

Accommodating ongoing review of spending with predictable funding

88. Continuity is a desirable feature in programs, both for their beneficiaries and their managers. For example, Canadians need to know what social security benefits they can depend on when they retire or what health care services will be available when they fall ill. For program managers, predictable funding—the financial equivalent of program continuity—facilitates planning and assignment of resources. It makes it easier to attract people with the right skills and to contract for necessary services over time. Predictability contributes to more efficient and effective program delivery, and for that reason it is a widely accepted principle of managing public spending.

89. However, sound management of public spending also requires ongoing review and evaluation of programs to ensure that they remain effective and consistent with the government's present priorities. These assessments could show at any time that spending on a particular program should be changed or eliminated. Clearly, ongoing review and funding certainty are not entirely compatible.

90. Procedures for reconciling the two include transparent budgeting, careful planning, and medium-term expenditure frameworks. Transparent budgeting makes clear to program managers the risk that funding could change, so they can anticipate and manage it. Careful planning helps limit the effects of funding cuts by timing them and distributing them in ways that minimize cost and disruption. It avoids easy measures that produce gains in the short term but have negative long-term impacts—measures such as skimping on key capital expenditures or critical control functions to make up for funding shortages. A medium-term expenditure framework commits funding over several years, providing stability within the planning horizon but flexibility in later years for reallocations. It does not preclude adjustments to unanticipated events, but it does give program managers reasonable certainty that funds will be available over the time horizon of the expenditure framework.

91. These considerations apply to the funding of ongoing programs. Funding for a special project or an infrastructure investment would take into account the project's time frame for completion and align funding commitments to requirements over that period. It is difficult to plan a project over several years without funding certainty, and it can be highly wasteful to tailor the project's completion to funding that does not materialize.

Chapter

1

Expenditure Management System at the Government Centre

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Expenditure Management System at the Government Centre

Main Points

What we examined

The Treasury Board Secretariat, the Department of Finance, and the Privy Council Office ("central agencies" of the federal government) have key roles and responsibilities in the government's Expenditure Management System (EMS). These include providing Cabinet with information to support spending allocation decisions and monitoring spending to ensure that it complies with authority and achieves the intended results. We examined the processes and procedures used by the central agencies to carry out their roles in the management of government spending. The main focus of the audit was the Treasury Board Secretariat, given its central role in the overall management of government resources.

However, we could not fully audit how the Treasury Board Secretariat reviews and challenges new spending proposals submitted to the Treasury Board. The Secretariat denied us access to the information and analysis it collects and prepares, citing Cabinet confidence of a type that cannot be disclosed to us. The government has effectively imposed a limitation on the scope of the Auditor General's examination.

Why it's important

The EMS is at the heart of government operations. The processes and procedures by which the central agencies of government support Cabinet in allocating and managing government spending are key components of the EMS. They are designed to help align resources with priorities, oversee spending, and establish the policies that departments will follow to manage and deliver their programs.

A sound and effective system for managing spending is central to the government's ability to carry out its fiscal responsibilities, fund its programs, control spending, and report financial and performance information to Parliament and the public. A system that works well promotes efficient, responsive, and accountable government. Without a good system, nothing that individual departments and agencies can do will result in sound overall management of government spending.

What we found

- Spending levels for existing programs and for new spending initiatives are approved on two separate tracks, making comparisons difficult. Spending on ongoing programs normally continues as a matter of course; new spending proposals are ranked among themselves without reference to existing programs. As a result, potential trade-offs and reallocation of resources between existing and new programs are not normally considered, except through ad hoc reviews of programs.
- The annual update of reference spending levels for ongoing programs is primarily a technical exercise that incorporates new spending approvals and adjustments for certain cost changes. It is not designed to review whether existing programs are still relevant, efficient, and effective.
- Under the current process, in effect since the late 1990s, departments may submit for Cabinet approval their proposals for new spending without specifying how the spending will be funded or put into effect. Cabinet committees therefore often approve spending initiatives without having this information before them. It is the Prime Minister and the Minister of Finance who subsequently decide on the funding of those initiatives. Details on program design and implementation are decided at the Treasury Board submission stage. The opportunity to affect spending levels at that stage is limited, however, because allocation decisions have already been made.
- The Expenditure Management System is not fully integrated with performance results. The current EMS does not require that departments submit data to demonstrate that they have used their funding effectively. The Treasury Board Secretariat has a limited capacity to monitor departments' compliance with the conditions and allotments imposed by the Treasury Board.

The government has responded. The Treasury Board Secretariat, the Department of Finance, and the Privy Council Office are in general agreement with our recommendations. Their detailed response follows each recommendation throughout the chapter. The government's overall response, included at the end of the chapter, indicates that the findings are generally consistent with its view of the present Expenditure Management System.

Introduction

Role of central agencies in the Expenditure Management System

1.1 Canada's central budgeting function is carried out by three central agencies: the Treasury Board Secretariat, the Department of Finance, and the Privy Council Office. The Treasury Board Secretariat plays a key role in managing government expenditures after Cabinet approves the allocation of funds. The other two are the key agencies involved in setting policy and spending priorities. The Department of Finance is mainly responsible for ensuring the integrity of Canada's finances and the Privy Council Office is responsible for ensuring that the allocation of resources is in line with the government's priorities.

1.2 **Role of Treasury Board Secretariat.** The Secretariat's role is to give the Treasury Board advice and support as it approves spending and oversees the financial management of departments and agencies. Specifically, the Secretariat reviews spending proposals and makes recommendations on the funding levels required to run government programs and meet government objectives. In addition, the Secretariat monitors government programs and advises the Board on whether the plans to deliver the programs are appropriate.

1.3 **Role of the Department of Finance.** As described in the Overview, the Department of Finance establishes the government's fiscal framework, which forecasts expenditure and revenue. The Department is involved in many expenditure management functions, including

- advising the Minister of Finance on overall spending priorities;
- reviewing proposals that departments and agencies bring before Cabinet committees to assess their fiscal impact, and to determine whether they are consistent with broad government objectives and how they will help improve economic growth and productivity;
- working with other central agencies and advising departments and agencies on their proposals; and
- ensuring that Cabinet ministers have adequate information on the comparative costs of proposals and their possible social or economic impact.

1.4 **Role of the Privy Council Office.** The Privy Council Office works closely with departments and agencies, the Prime Minister's Office, the Treasury Board Secretariat, and the Department of Finance

to ensure that new proposals comply with the government's overall objectives and policies and to ensure that those that may be affected are consulted. The Privy Council Office also reviews new spending initiatives to determine whether policy proposals are sound, and cost estimates are reasonable. Once Cabinet reaches a decision, the Privy Council Office is responsible for ensuring that the departments and agencies are informed of the decision.

1.5 **Expenditure Management System review.** While we were conducting our audit, the government announced, in its May 2006 budget, that it was reviewing the Expenditure Management System. This review was led by the President of the Treasury Board, and a report on a new approach was scheduled to be published by the fall of 2006.

1.6 The budget reported that the new approach to manage expenditures will respect the following principles:

- Government programs need to focus on results and value for money.
- Government programs must be consistent with federal responsibilities.
- Government programs that no longer serve the purpose for which they were created need to be eliminated.

Focus of the audit

1.7 We focused on the procedures that the central agencies use to support funding decisions and to monitor spending. We wanted to assess whether the central agencies' current Expenditure Management Framework is appropriately designed and implemented to support decisions made about the allocation and reallocation of resources and to provide effective oversight of expenditures.

1.8 We attempted to review the processes and procedures that the central agencies (primarily the Treasury Board Secretariat, but also the Department of Finance and the Privy Council Office) follow to give Cabinet the information it needs to make decisions on the allocation of funds and management of government spending.

1.9 We intended to include four areas of the expenditure management in our review:

- review of reference levels,
- assessment of new or enriched spending proposals,

- control and oversight of expenditures, and
- alignment of funding commitments and their timing with actual funding requirements.

1.10 We were unable to fully determine how the Treasury Board Secretariat reviews and challenges new spending proposals. This is because the Secretariat, citing Cabinet confidence of a type that cannot be disclosed to us, denied us access to the information and analysis it collects and prepares.

1.11 The Auditor's General reporting obligations are set out in section 7 of the *Auditor General Act*. Under section 13 of the Act, we have a right of access to all the information and explanations necessary to fulfill these obligations. We are required to report to Parliament when we do not receive all the information and explanations we require. By denying us access to the documents we need, the government has effectively imposed a limitation on our audit scope that could diminish Parliament's fundamental role of holding the government to account. This could be viewed as an infringement of the privileges of the House of Commons. However, only the House itself can determine whether such a breach has occurred.

1.12 More details on our audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Expenditure management during times of budget surpluses

The Expenditure Management System has become less effective since the budget went into surplus

1.13 As mentioned in the Overview, a system set up when resources are limited does not always work well when there is a budget surplus. The current Expenditure Management System was designed in the mid-1990s when the government was trying to control its spending to deal with the budget deficit. Departments and agencies had to operate in a fiscal environment that restricted new funding as much as possible.

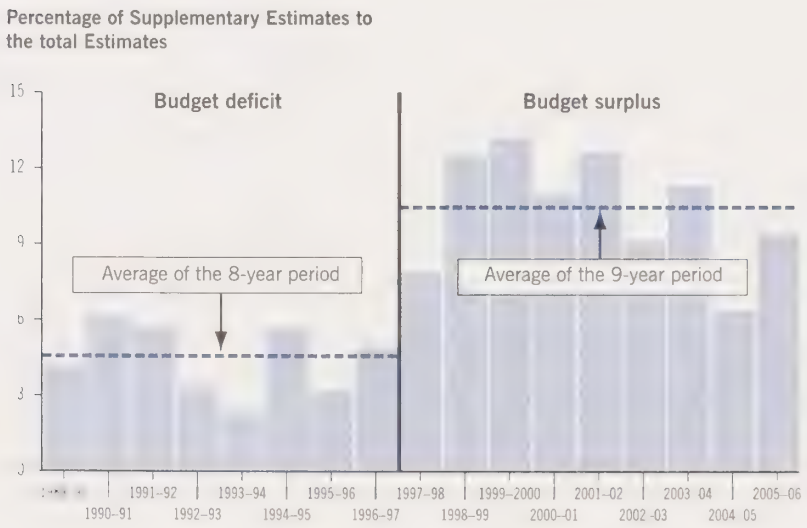
1.14 The Expenditure Management System was designed to include a strong review and challenge component and, if possible, to get departments and agencies to reallocate money from existing programs to new programs. When surpluses began to accumulate, the pressure to reallocate resources lessened.

1.15 Since 1997, the availability of resources has led to more incremental budgeting—increasing departmental budgets each year to respond to new demands rather than reallocating from existing budgets. These decisions on spending increases are often made too late in the budget cycle to be included in the Main Estimates.

1.16 To be included in the Main Estimates for the following fiscal year, spending decisions must normally be made before November. Therefore, unless they are submitted to Treasury Board much earlier, decisions announced in the February Budget cannot be incorporated in the Main Estimates and have to be approved through Supplementary Estimates or specific legislation.

1.17 Since the federal budget went from a deficit to a surplus, the reliance on Supplementary Estimates to seek parliamentary approval of spending has increased significantly. For example, between 1989–90 and 1996–97, years in which there were deficits, Supplementary Estimates made up an average 4.5 percent of the total Estimates submitted to Parliament. Between 1997–98 and 2005–06, years in which there were surpluses, that percentage more than doubled to 10.4 percent (Exhibit 1.1).

Exhibit 1.1 The average percentage of Supplementary Estimates to total Estimates more than doubled when the budget went into surplus



Source: Calculations by the OAG based on Main Estimates and Supplementary Estimates, 1989–90 to 2005–06 (Supplementary Estimates 2005–06 were tabled, but not approved by Parliament)

Funding for existing programs

The Treasury Board Secretariat annually updates funding for existing programs, without a systematic review

1.18 Every year, the Treasury Board Secretariat updates funding levels totalling tens of billions of dollars for departments and agencies. These levels forecast the direct spending that the Treasury Board will approve, and Parliament will appropriate.

1.19 As described in the Overview, departments and agencies make a Treasury Board submission each year, asking the Treasury Board to approve their reference levels through the Annual Reference Level Update (ARLU) process. The Treasury Board Secretariat and the departments review the funds that the Treasury Board approved in the previous year and establish **reference levels** for the next fiscal year and the two following planning years. The Department of Finance updates the forecasted public debt charges and statutory program expenditures for the ARLU process

Reference level—The amount of funding that the Treasury Board has approved for departments and agencies to carry out policies and programs for each year of the planning period.

1.20 It is important to note that the ARLU process is not designed to consider past performance and results of programs. Reviews and evaluations do take place on occasion outside the ARLU process, but performance information is not integrated with the regular annual process used to renew spending for ongoing programs. Each year, the Treasury Board Secretariat recommends that the Treasury Board approve ongoing funding for programs, without assessing whether they remain effective and relevant, or whether they still represent value-for-money.

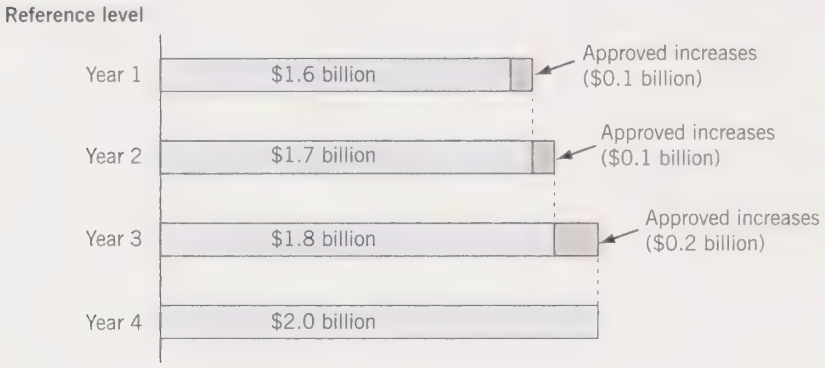
1.21 For example, the Treasury Board approved approximately $64 billion for 2004–05 and $66 billion for 2005–06 in "Direct Program Spending" (funding of existing programs that is approved annually by Parliament). Little program information was available at the government centre to provide assurance that these programs remained relevant, effective, and efficient.

1.22 Occasionally, program funding will be linked to performance and results. For example, the Secretariat will consider past performance when it decides whether to recommend that the Treasury Board renew funding for a program whose funding commitment is about to end. There is also a requirement that grants and contributions programs be reviewed every five years.

1.23 The ARLU process is a technical exercise that updates the reference levels and is not a mechanism for departments to request new funding. Reference levels for ongoing programs of departments or agencies are updated from year to year. Exhibit 1.2 shows how

approved increases to reference levels of ongoing programs may accumulate as part of the reference levels for future years—it is a hypothetical example, not based on an actual department. Reference levels may also decrease.

Exhibit 1.2 An example of how departmental reference levels for ongoing programs are updated from year to year



Updating reference levels is a technical exercise, and the government's current expenditure practices do not include a systematic review of ongoing programs.

1.24 Under the existing Expenditure Management System, there is no comprehensive or systematic review to assess the effectiveness or relevance of ongoing programs. Efforts to reallocate resources are linked primarily to ad hoc expenditure reviews, which may take place several years apart. In recent years, there have been a number of government-wide exercises to reallocate and cut expenditures, including

- the 1994 Program Review,
- the 2003 initiative to reallocate $1 billion,
- work by the Expenditure Review Committee in 2004 that reported prospective savings of $11 billion, and
- the $1-billion review announced in the 2006 Budget.

1.25 Because demands for resources are constantly evolving, programs need to be reviewed on a regular basis. The central agencies need these reviews to assess whether spending and shifting priorities remain aligned, and whether the programs still represent value for money. For information about the expenditure management practices that some other public sector jurisdictions use, see Appendix A.

1.26 Considering the Secretariat's stewardship responsibilities, the large amount of spending on programs, and the importance of using public funds effectively, the Secretariat needs better information on program results and performance. Such data would facilitate the review of reference levels for ongoing programs and help identify programs that are not producing the intended results.

1.27 **Recommendation.** The central agencies (the Treasury Board Secretariat, the Privy Council Office, and the Department of Finance) should ensure that ongoing programs and reference levels are reviewed systematically to assess whether these programs and their funding remain relevant, and whether they still represent value-for-money.

Central agencies' response. Designing and implementing a process of systematic review of existing programs is one of the priority areas of concern of the government. The government has committed to the following:

- programs should focus on results and value-for-money,
- programs must be consistent with federal responsibilities, and
- programs that no longer serve the purpose for which they were created should be eliminated.

The Secretariat lacks necessary financial and performance information to perform its expenditure oversight

1.28 Expenditure oversight and control are designed to provide reasonable assurance that resources are used efficiently and effectively, in compliance with authority, and that the expected results are achieved. To perform its expenditure oversight, the Secretariat must have access to timely, comprehensive, and reliable information on program costs and performance. Currently, the information available to the Secretariat, and the other central agencies, is weak, especially information on how effective the programs are.

1.29 Monitoring existing programs for their cost and their effectiveness is a standard requirement in government. However, the Expenditure Management System does not require that departments and agencies submit performance data to demonstrate that they have used their funding effectively. This gap in information exists even though the Secretariat is currently modernizing the program evaluation policy and uses a considerable number of resources and effort to help departments and agencies evaluate the performance of their activities.

1.30 As the Treasury Board Secretariat noted in its recent *Review of the Responsibilities and Accountabilities of Ministers and Senior Officials*, the information management systems and data collection processes are not serving the Treasury Board and the Secretariat well, as they perform their oversight role. The Secretariat's program analysts perform most of the oversight and rely on limited information provided by departments and agencies.

1.31 To perform its expenditure oversight responsibilities, the Treasury Board Secretariat needs to have access to and needs to use timely, comprehensive, and reliable financial and performance information. The Expenditure Management System does not use performance reviews as evidence and does not give the Secretariat the program information that it needs to identify possible problems.

1.32 The Treasury Board Secretariat has recently introduced the Management, Resources, and Results Structure (MRRS) policy and is implementing a new Expenditure Management Information System (EMIS). The EMIS is a government-wide information system that is designed to improve the expenditure decision-making process. The MRRS policy is a new approach that is designed to improve the analysis and quality of the information on programs and spending.

1.33 These initiatives are underway and have not yet been fully implemented. Important challenges still need to be addressed (see Chapter 3, Large Information Technology Projects). It is still unclear how successfully these government-wide initiatives will provide expenditure data by program and support the allocation and reallocation decisions. The Secretariat is also reviewing the program evaluation policy that the departments use.

1.34 **Recommendation.** The Treasury Board Secretariat should collect and use comprehensive information on program costs and performance to perform its spending oversight responsibilities.

The Treasury Board Secretariat's response. The Treasury Board Secretariat agrees with the recommendation: Accurate, timely, relevant, and reliable financial and non-financial information, on programs objectives and results, is critical to all functions of an effective Expenditure Management System. The Secretariat also recognizes that financial information must be integrated with performance information. Indeed, that is the purpose of the Management, Resources, and Results Structure Policy that the Treasury Board put in place April 2005. In addition, the *Federal Accountability Act* proposes to improve

performance information through the strengthening of the evaluation function in departments in respect of grants and contributions.

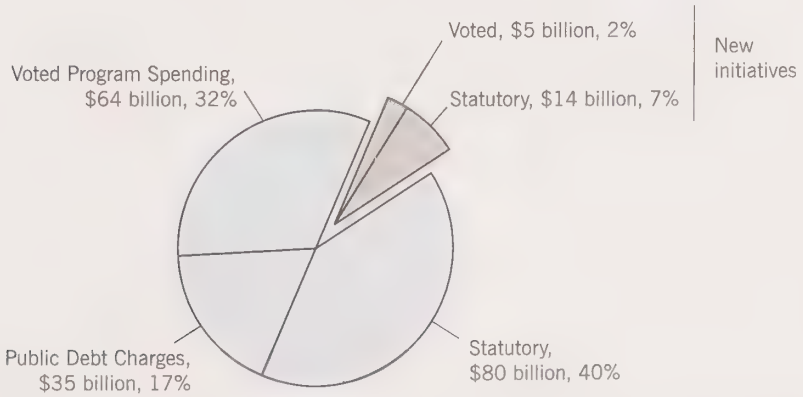
New or enriched spending initiatives

Opportunities for trade-offs between new and ongoing spending may be missed

1.35 Two expenditure management processes exist: one for renewing spending for existing programs and another for reviewing new spending initiatives. As explained earlier, spending on existing programs moves forward automatically, through the ARLU process. Funding decisions are, therefore, mostly about how to allocate increases in aggregate spending among new initiatives. As a result, potential trade-offs between new and ongoing spending initiatives may be missed. Existing programs do not regularly compete with new spending initiatives for resources.

1.36 In 2004–05, planned spending on new programs totalled $19 billion—$14 billion in statutory spending and $5 billion in voted spending. In that same year, planned spending on existing programs totalled $144 billion—$64 billion in voted program spending and $80 billion in statutory spending (Exhibit 1.3).

Exhibit 1.3 In 2004–05 new spending initiatives made up 9% of total planned government expenditures



Source: OAG, based on Main Estimates, Supplementary Estimates, and legislations authorizing spending. Program expenses figures are on a net basis, as estimated in the Estimates.

1.37 Reallocating spending from less to more valued programs is also difficult because spending decisions are often approved in principle at the Memorandum to Cabinet stage, even though important program details are often missing, including how spending initiatives will be designed and delivered, and how much they will cost. These program details are developed later at the Treasury Board Submission stage.

1.38 A large proportion of new spending in recent years consisted of spending initiatives adopted outside the regular budget cycle. Each year, as projected revenues grow, new or enriched spending initiatives are announced, on top of spending already approved in the previous Budget or Estimates process. Circumstances will sometimes dictate when spending decisions are made. For example, soon after the December 2004 Tsunami in South Asia, the government announced new funding—totalling $265 million—for assistance.

1.39 However, other off-budget cycle spending decisions have been made that cannot be attributed to unanticipated events. For example, in February 2003, the government announced $600 million for the Canada Health Infoway. In September 2004, it announced that $4.75 billion in payments would be made to the provinces for the purchase of medical equipment and the reduction of health care wait times. In February 2005, the government announced $165 million in funding for Genome Canada. The funding for these announcements was accounted for or expensed in the year that the announcements were made.

1.40 The timing of these off-budget cycle announcements makes it difficult for government to comprehensively assess spending initiatives. A sound principle of public expenditure management is for spending proposals to be assessed together early in the budget cycle. This would allow decision makers to compare all policy proposals together and consider trade-offs between the available resources and outstanding priorities.

1.41 Under the Expenditure Management System, as it operated before 1998, departments and agencies were required to identify a source of funds for all new policy proposals that they submitted in memoranda to Cabinet. That is no longer the case. Departments can now submit spending proposals without identifying the source of funds. The source of funds will be identified later (from a reallocation of resources from the existing reference levels or the fiscal framework, at the prerogative of the Prime Minister and the Minister of Finance). This means that departments are encouraged to submit unfunded proposals and are less likely to consider reallocation as a source of funds.

The central agencies cannot always properly assess new proposals

1.42 **Memoranda to Cabinet.** Memoranda to Cabinet are what departments use to request that Cabinet approve new spending proposals; they usually indicate the total resources that will be required, but do not contain details of specific funding requirements for individual

aspects of the policy. It is important that new spending proposals be rigorously reviewed and challenged before Cabinet approves them. The central agencies and Cabinet need complete and accurate information to thoroughly review the proposals and make sound decisions.

1.43 According to the central agencies, information in memoranda to Cabinet is not always complete:

- The Secretariat noted that memoranda to Cabinet sometimes lack measurable objectives and results commitments and that information on costing alternatives and evaluating and measuring results for existing programs is not always adequate.
- The Department of Finance noted that the quality of memoranda varies widely.
- The Privy Council Office noted that analyses that support the memoranda is uneven, that fundamental questions are not always addressed, that savings are not routinely identified, and that credible alternatives are not always researched.

1.44 These problems with memoranda to Cabinet occur despite the guidance the Privy Council Office gives to departments and agencies. These problems limit the central agencies' ability to review new spending initiatives effectively and can affect the quality of Cabinet's decisions.

1.45 The central agencies told us that they do not always have enough time to assess memoranda to Cabinet. The Privy Council's Office sets a standard time of two weeks for the Treasury Board Secretariat and the Department of Finance to review the memoranda. However, the central agencies told us that they are sometimes forced to complete their reviews within a few days.

1.46 **Treasury Board submissions.** A Treasury Board submission is an official document that a department or agency submits to seek approval from Treasury Board ministers to carry out a proposal. As explained in the Overview, even after Cabinet approves a policy initiative, the department or agency still requires Treasury Board approval to carry out the initiative. A submission includes details of the program's design and delivery, how much it will cost each year, expected results and outcomes, and other required information.

1.47 The Treasury Board Secretariat is responsible for reviewing the submissions, focusing on "how to spend and implement the policy initiative." This is an iterative process involving the Secretariat's experts and program sector analysts, and experts from the departments and agencies.

1.48 According to the Secretariat, once a source of funds has been identified, its program sector analysts assess and review the submissions, using the following criteria:

- conformity with authorities,
- fit with government priorities,
- affordability,
- effectiveness,
- program delivery,
- performance measurement, and
- safeguards to protect public funds.

1.49 When all of the Secretariat's concerns have been addressed, its analysts recommend that Treasury Board ministers approve the final submission as proposed by the department. Reviews at the Treasury Board submission stage have little impact on resource allocation because funding decisions have already been made. The question Treasury Board typically decides is how the allotted funds will be spent, not how much it is appropriate to spend.

1.50 One of our audit objectives was to determine whether there are adequate systems and procedures to assess new spending proposals. The Treasury Board Secretariat has denied us access to the information and analysis it collects and prepares on Treasury Board submissions, citing Cabinet confidence of a type that cannot be disclosed to us. As a result, we were not able to assess how the Secretariat reviews and challenges new spending initiatives.

1.51 The weaknesses at the memoranda to Cabinet and Treasury Board submission stages limit the central agencies' ability to review the merits of spending proposals and determine opportunities for trade-offs between existing and new programs. As the central agencies review the Expenditure Management System and develop a new approach to managing expenditures, they need to consider these problems.

1.52 Recommendation. The central agencies (the Treasury Board Secretariat, the Department of Finance, and the Privy Council Office) should ensure that they have complete and accurate information that

- supports the review and approval of new spending initiatives, and
- allows new spending initiatives to be assessed against existing programs to determine whether funding should be reallocated.

Central agencies' response. The Privy Council Office, the Department of Finance, and the Treasury Board Secretariat agree with the recommendation: Accurate, timely, relevant, and reliable financial and non-financial information on programs objectives and results is critical to all functions of an effective Expenditure Management System. Cabinet documents and supporting processes should provide the cost and results information needed for all aspects of decision making and allow for the integration of decisions on allocation and reallocation across existing and new proposals.

1.53 Recommendation. The central agencies (the Treasury Board Secretariat, the Department of Finance, and the Privy Council Office) should also clarify their roles—particularly the Treasury Board Secretariat's role and its ability to challenge and influence funding decisions more effectively—in the Expenditure Management System.

Central agencies' response. The central agencies agree that clarity of roles and responsibilities is essential.

Program funding does not always align with the financial requirements over time

1.54 The timing for funding new spending initiatives varies. Programs with short life expectancies are usually funded with temporary funding, considering the short-term time frames over which the projects are planned to be completed. Other programs have longer-term funding requirements—meaning funds need to be committed for a longer period.

1.55 Programs do not always receive funding that meets their long-term financial requirements. The Treasury Board Secretariat told us that temporary funding can protect the government's fiscal position. The central agencies need to consider the government's long-term fiscal position when they decide how long to fund new spending initiatives.

1.56 The Secretariat also told us that temporary funding forces departments and agencies to assess programs periodically. For example, these assessments help to ensure that program needs and financial requirements are still justified, program costs are kept under control, and the desired program results are achieved.

1.57 Finally, the Secretariat stressed that temporary funding allows the central agencies more flexibility as they make decisions about allocation and reallocation of funds, which makes it easier for them to adjust to changing government priorities.

1.58 Temporary or short-term funding can serve a variety of purposes. However, unpredictable funding can jeopardize the delivery and sustainability of long-term government projects or activities. For example, research and development work that continues for long periods of time benefits from stable, long-term funds.

1.59 If funding does not align with what the program actually requires, planning can be difficult. In addition, because temporary funding requires frequent adjustments to departments' budgets, it can lead to increased reliance on Supplementary Estimates.

1.60 In the following chapters, we reported on the need for predictable funding for government activities with longer-term financial requirements:

- December 2000 Report, Chapter 31, Fisheries and Oceans—Fleet Management, paragraph 31.69
- December 2001 Report, Chapter 3, Recruiting for Canada's Future Public Service—Changing the Practices, paragraphs 3.59 and 3.73
- December 2002 Report, Chapter 11, Other Audit Observations: Atomic Energy of Canada Limited, paragraphs 11.133 and 11.135
- April 2005 Report, Chapter 1, Natural Resources Canada—Governance and Strategic Management, paragraph 1.13

1.61 In Chapter 2, Expenditure Management System in Departments, we report that the funding given to programs does not always reflect their financial requirements. We also report concerns raised by departments that the timing of funding for programs may adversely affect their ability to manage programs.

1.62 Balancing the program requirements with the need to protect the government's fiscal position to review and evaluate programs, and to respond to changing priorities may cause tensions between the central agencies and the departments.

1.63 These tensions do not necessarily mean that the expenditure management process has failed. They may be the result of central agencies' attempts to control the flow of funds, to promote restraint, or to make departments and agencies more efficient. Nevertheless, in our view, the expenditure management process needs to acknowledge that short-term funding can adversely affect programs that have long-term financial requirements and must seek ways to minimize these adverse impacts.

1.64 Recommendation. The central agencies (the Treasury Board Secretariat, the Department of Finance, and the Privy Council Office) should review how they determine and recommend funding of programs with long-term financial requirements. The funding for these programs should be as predictable as possible and aligned to program requirements.

Central agencies' response. Enhancing the information in Cabinet documents so that it better supports the decision-making process is a key objective of the new Expenditure Management System. Improved information, including comprehensive costing information, as well as rigorous exploration of the benefits and risks associated with identified options, are key to enabling sound decisions. Clear initial funding decisions, based on comprehensive information in memoranda to Cabinet, should lead to clear alignment between program funding and objectives.

There are many instances where the government may decide not to provide funding on an ongoing basis. The need and objectives themselves may be time-limited or innovative programming approaches may be used that must be assessed to ensure the program is achieving the desired objectives. Responsible and accountable stewardship of taxpayers' dollars requires the continual reassessment of the value of existing programs and the ongoing search for new, more cost-effective ways to deliver government programs that achieve results for Canadians and maximize value-for-money. The need for continuous reassessment must be balanced with the need for stability and predictability for sound program management.

The Treasury Board Secretariat does not adequately monitor conditions that the Treasury Board attaches to departmental spending

1.65 Normally departments or agencies may reallocate funds between different activities within an approved vote, without seeking parliamentary approval. The government encourages them to do so to deal with spending pressures. However, in certain circumstances, when departments and agencies reallocate funds between programs, they may limit their ability to reach program objectives and to stay consistent with government priorities.

1.66 The Treasury Board sometimes uses special purpose allotments to restrict the use of a portion of funds to a specific purpose. The Secretariat does not review the use of special purpose allotments to provide assurance to the Treasury Board that departments and agencies

are using the funds for the specified purpose. The Secretariat is of the view that departments and agencies are responsible for ensuring that the special purpose allotments are only used for their specified purpose. At the end of the year, departments and agencies provide the Treasury Board with expenditure information that shows how they used the special purpose allotments. This information is published annually in the *Public Accounts of Canada*—the government's annual report on how it spent the funds appropriated by Parliament.

1.67 The Treasury Board can control how departments and agencies use funds by attaching financial conditions to individual decisions at the Treasury Board submission stage. "Frozen allotments" are used to limit access to the full spending authority provided by Parliament in a particular vote. For example, frozen allotments could be created pending a department's fulfillment of outstanding conditions imposed by the Treasury Board. The Secretariat is responsible for ensuring that those conditions are met before they recommend that frozen allotments be released to the department or agency.

1.68 In some cases, funding is approved with non-financial conditions attached (for example, reporting or evaluation requirements). The meeting of the non-financial conditions by the department or agency is not a prerequisite for the Treasury Board to approve the funds. The Treasury Board Secretariat has a limited capacity to monitor departments' and agencies' compliance with these conditions.

1.69 **Recommendation.** The Treasury Board Secretariat should track the conditions that the Treasury Board attaches to its spending decisions to determine whether those conditions are all being met.

The Treasury Board Secretariat's response. The Treasury Board Secretariat currently tracks all financial conditions. This functionality, along with improvements to the tracking of non-financial conditions, will be built into the new Expenditure Management Information System.

Conclusion

1.70 The Expenditure Management System is at the heart of the operation of government. Effective expenditure decision making is critical to ensure value-for-money and effectiveness of government spending. This requires a process that promotes rigorous review of spending and facilitates the reallocation of funds from low priorities or ineffective programs to higher priorities or more effective programs.

The current Expenditure Management System, designed when Canada was in a budget deficit, is less effective in a time of surpluses.

1.71 Our audit identified a number of weaknesses in the Expenditure Management System:

- **The Expenditure Management System does not appropriately support the allocation and reallocation of funds.** The Annual Reference Level Update (ARLU) is not designed to take into account performance results and does not allow the Treasury Board Secretariat to challenge the allocation of resources using evidence on program effectiveness. Therefore, except for the ad hoc expenditure reviews, reference levels are not reviewed at the centre of government. The adequacy of funding and value-for-money of ongoing programs cannot be ensured.
  There are two expenditure management processes: one for recommending the reference levels of existing programs and one for reviewing new spending initiatives. Spending on ongoing programs essentially moves forward automatically; new spending proposals are ranked independently and are not assessed against existing programs. As a result, trade-offs and reallocation of funds between existing and new programs are not considered systematically. Furthermore, the detailed consideration of spending proposals at the Treasury Board submission stage has little impact on resource allocation because funding decisions are made earlier. Finally, funding decisions made at the government centre do not always align the program funds with longer term financial requirements.

- **The Treasury Board Secretariat's oversight of expenditures is limited.** The Secretariat does not have adequate access to quality program information, which limits its ability to oversee expenditures and intervene when deficiencies are identified. The Secretariat is also limited in its capacity to monitor compliance with the conditions and special purpose allotments imposed by the Treasury Board.

1.72 We could not fully review how the Treasury Board Secretariat performed its function of assessing and challenging spending proposals submitted to the Treasury Board. The Secretariat denied us access to the information and analysis it collects and prepares, citing Cabinet confidence of a type that cannot be disclosed to us. The government has effectively imposed a limitation on the scope of the Auditor General's examination.

1.73 The government has committed to reviewing the Expenditure Management System. It would be appropriate to introduce changes that will lead to a better system, including

- regular expenditure reviews of reference levels to ensure that existing programs are relevant and represent value-for-money,
- access to and use of performance information in the spending decision process,
- adequate systems and procedures for central agencies to assess new spending proposals and relate them to existing programs,
- timing of funding being appropriately aligned with the program requirements, and
- capacity to effectively monitor the conditions and special purpose allotments being imposed by the Treasury Board.

The government's overall response. The government recognizes that a new ongoing approach is needed to manage overall spending to ensure, as stated in Budget 2006, "…all government programs are effective and efficient, are focused on results, provide value for taxpayers' money and are aligned with the government's priorities and responsibilities." The issues raised by the Office of the Auditor General in this report are generally consistent with those that the government believes a new expenditure management system should address.

The new Expenditure Management System (EMS) will entrench responsible spending. It will require that all new and existing programs go through a systematic and rigorous examination. This will ensure that the government only approves funds that are actually needed to achieve measurable results in a way that is effective, and provides value-for-money on behalf of Canadians.

The EMS renewal is a critical building block for government-wide, results-based management and a stronger accountability regime. Important steps in the renewal process have already been taken, such as the *Federal Accountability Act* and the Management, Resources, and Results Structure Policy, but further work remains.

About the Audit

Objectives

Our audit objectives were to assess whether the current Expenditure Management System is appropriately designed and implemented to support the allocation and reallocation of resources and effective expenditure oversight.

Scope and approach

We reviewed the processes and procedures used by the central agencies (primarily the Treasury Board Secretariat, but also the Department of Finance and the Privy Council Office) to manage government spending, to determine whether

- the existing Annual Reference Level Update (ARLU) provides for effective review and challenge of baseline government spending,
- the current systems and procedures adequately assess new spending proposals and relate them to existing programs and commitments,
- the Treasury Board Secretariat is able to monitor spending in departments and agencies to ensure that the spending complies with authority and achieves the desired results, and
- the process used to support resource allocation works effectively to align funding commitments with long-term funding requirements.

We collected most of our evidence by interviewing key officials from the central agencies and by reviewing

- budgets,
- Treasury Board submissions,
- records of decisions,
- memoranda to Cabinet, and
- other related documents and reports.

We also

- interviewed officials in other jurisdictions to better understand processes used to manage expenditures,
- interviewed Expenditure Management System experts in Canada and abroad,
- met with ex-senior officials from the Department of Finance and the Treasury Board Secretariat, and
- reviewed literature on the subject.

We could not fully audit how the Treasury Board Secretariat reviews and challenges new spending proposals submitted to the Treasury Board. The Secretariat denied us access to the information and analysis it collects and prepares, citing Cabinet confidence of a type that cannot be disclosed to us. The government has effectively imposed a limitation on the scope of the Auditor General's examination.

Criteria

We expected the Treasury Board Secretariat to use financial and non-financial information to review and analyze existing spending to ensure that program needs are met and desired results are achieved.

We expected the Secretariat to ensure that departments and agencies regularly review program spending.

We expected that before new spending initiatives are approved, the Secretariat would assess

- the legality of the spending proposals;
- how new spending initiatives fit with the government's priorities and existing programs;
- affordability and sustainability;
- how intended results will be achieved and assessed (effectiveness);
- how well programs will be delivered and will meet objectives;
- whether public interest is safeguarded (prudence, probity, and equity); and
- the source of funding.

We expected that the central agencies involved in the allocation of resources to coordinate their efforts.

We expected that the Treasury Board to have reasonable assurance that the departments and agencies' management frameworks are adequate to ensure that they use resources efficiently, effectively, and in compliance with authority.

We expected the Secretariat to make use of sound and timely departmental information on program expenditures and performance results.

We expected management frameworks to support allocation decisions that align funding commitments with longer term funding requirements.

Audit work completed

Audit work for this chapter was substantially completed on 11 July 2006.

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Appendix A Expenditure management practices

The following describe expenditure management practices that the United Kingdom, Australia, the United States, Chile, and the province of Ontario follow to review baseline funding for effectiveness and results. While we did not audit how well these expenditure management practices work, they provide examples of how other public sector jurisdictions have sought to integrate regular, comprehensive spending reviews into their expenditure management systems.

The United Kingdom

The United Kingdom, through Her Majesty's Treasury, has been allocating resources under a new public expenditure framework since the first comprehensive spending review in 1998. Spending reviews set firm and fixed three-year departmental expenditure limits.

Three-year budgets and year-end flexibility give the departments the funding stability required to plan their operations. Departments cannot seek annual spending increases. Every 2 years, 15 Treasury spending teams, with a total of 200 analysts, challenge departmental submissions and review multi-year reference levels.

The 2007 Comprehensive Spending Review will review departmental allocations for 2008–09, 2009–10, and 2010–11. Allocations for 2007–08 will be held to the figures agreed to and announced at the 2004 Comprehensive Spending Review. The government of the United Kingdom states that to ensure that these departmental allocations are rigorously analyzed and to secure value for money from public spending over the review period, it will assess the resources needed to address government priorities. The 2007 Comprehensive Spending Review will also set zero-based reviews of departments' baseline expenditure to assess its effectiveness in delivering the government's long-term objectives.

United States

In 2002, as part of the 1993 *Government Performance and Results Act,* the United States introduced the Program Assessment Rating Tool (PART). The PART questionnaire is used to assess the quality of design, goals, management, and results of existing federal programs, to determine how effective the programs are. Every year, 20 percent of the federal budget is assessed.

The objectives of PART are to

- assess and improve the performance; and
- link performance to budget decisions, by helping to ensure that spending recommendations improve results.

According to the United States federal government, PART helps decision makers focus their attention on the most pressing policy issues and helps them make appropriate decisions and trade offs.

Australia

In the early 1980s, Australia introduced "forward estimates" to address deficiencies in its annual budget process. Forward estimates focus on expenditures for three years beyond the current fiscal year and are adjusted regularly to allow for inflation and policy changes. These estimates enable the government to plan program and spending priorities for future budgets.

The Expenditure Review Committee was established in the mid-1980s. It determines the Australian federal government's overall fiscal framework and manages strategic policy making, including policy changes that reflect fiscal realities and shifting government priorities.

Recently, the Cabinet Implementation Unit was established to monitor the government's priority initiatives, and the Department of Finance and Administration adopted Gateway Reviews, a systematic review of key stages of major, often horizontal initiatives.

Chile

The Chilean budget cycle has two distinct phases:

- reviewing ongoing programs and baseline funding; and
- funding new or enhanced programs, through a central bidding fund.

Every spring, the budget office reviews the execution of the previous year's budget and evaluates the implementation of the budget during the current year. The objective of this review is to free up resources to finance new spending initiatives. This includes a systematic assessment of program's performance and results, which can change program funding. "Efficiency dividends" can also be deducted from the expenditure ceilings.

The second phase of the Chilean expenditure process focuses on the "bidding fund," which is a pool of unallocated resources that results from the critical examination of existing programs and the revenues from a growing economy. The Budget Office reviews the technical quality of the submissions and the consistency of the bid with the government priorities and proposes a list of new spending initiatives to the Ministry of Finance and to the President of Chile.

Province of Ontario

The Government of Ontario uses a results-based planning framework to establish its reference levels for existing and new spending. The focus of the framework is on achieving specific results in support of government priorities. This "managing for results" approach integrates planning, budgeting, and measuring performance, and aligns performance with priorities and expected results. This approach to decision making uses zero-based budgeting and continuously improves the delivery of programs and services for customers.

Ontario's Treasury Board Office supports performance measurement, program review, and program evaluation. Submissions proposing new initiatives are required to identify the impact that the initiative may have on government priorities and results, other stakeholders and sectors, and opportunities for integration. Allocation decisions are made on a multi-year basis, usually for a minimum of four years.

Appendix B List of recommendations

The following is a list of recommendations found in Chapter 1. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Central agencies' response
Funding for existing programs	
1.27 The central agencies (the Treasury Board Secretariat, the Privy Council Office, and the Department of Finance) should ensure that ongoing programs and reference levels are reviewed systematically to assess whether these programs and their funding is still relevant, and whether they still represent value-for-money. **(1.18–1.26)**	Designing and implementing a process of systematic review of existing programs is one of the priority areas of concern of the government. The government has committed to the following: • programs should focus on results and value-for-money, • programs must be consistent with federal responsibilities, and • programs that no longer serve the purpose for which they were created should be eliminated.
1.34 The Treasury Board Secretariat should collect and use comprehensive information on program costs and performance to perform its spending oversight responsibilities. **(1.28–1.33)**	The Treasury Board Secretariat agrees with the recommendation: Accurate, timely, relevant, and reliable financial and non-financial information, on programs objectives and results, is critical to all functions of an effective Expenditure Management System. The Secretariat also recognizes that financial information must be integrated with performance information. Indeed, that is the purpose of the Management, Resources, and Results Structure Policy that the Treasury Board put in place April 2005. In addition, the *Federal Accountability Act* proposes to improve performance information through the strengthening of the evaluation function in departments in respect of grants and contributions.

Recommendation	Central agencies' response
New or enriched spending initiatives	
1.52 The central agencies (the Treasury Board Secretariat, the Department of Finance, and the Privy Council Office) should ensure that they have complete and accurate information that • supports the review and approval of new spending initiatives, and • allows new spending initiatives to be assessed against existing programs to determine whether funding should be reallocated. **(1.35–1.51)**	The Privy Council Office, the Department of Finance, and the Treasury Board Secretariat agree with the recommendation: Accurate, timely, relevant, and reliable financial and non-financial information on programs objectives and results is critical to all functions of an effective Expenditure Management System. Cabinet documents and supporting processes should provide the cost and results information needed for all aspects of decision-making and allow for the integration of decisions on allocation and reallocation across existing and new proposals.
1.53 The central agencies (the Treasury Board Secretariat, the Department of Finance, and the Privy Council Office) should also clarify their roles—particularly the Treasury Board Secretariat's role and its ability to challenge and influence funding decisions more effectively—in the Expenditure Management System. **(1.35–1.51)**	The central agencies agree that clarity of roles and responsibilities is essential.

Recommendation	Central agencies' response
1.64 The central agencies (the Treasury Board Secretariat, the Department of Finance, and the Privy Council Office) should review how they determine and recommend funding of programs with long-term financial requirements. The funding for these programs should be as predictable as possible and aligned to program requirements. **(1.54–1.63)**	Enhancing the information in Cabinet documents so that it better supports the decision-making process is a key objective of the new Expenditure Management System. Improved information, including comprehensive costing information, as well as rigorous exploration of the benefits and risks associated with identified options, are key to enabling sound decisions. Clear initial funding decisions, based on comprehensive information in memoranda to Cabinet, should lead to clear alignment between program funding and objectives. There are many instances where the government may decide not to provide funding on an ongoing basis. The need and objectives themselves may be time-limited or innovative programming approaches may be used that must be assessed to ensure the program is achieving the desired objectives. Responsible and accountable stewardship of taxpayers' dollars requires the continual reassessment of the value of existing programs and the ongoing search for new, more cost-effective ways to deliver government programs that achieve results for Canadians and maximize value-for-money. The need for continuous reassessment must be balanced with the need for stability and predictability for sound program management.
1.69 The Treasury Board Secretariat should track the conditions that the Treasury Board attaches to its spending decisions to determine whether those conditions are all being met. **(1.65–1.68)**	The Treasury Board Secretariat currently tracks all financial conditions. This functionality, along with improvements to the tracking of non-financial conditions, will be built into the new Expenditure Management Information System.

The government's overall response

The government recognizes that a new ongoing approach is needed to manage overall spending to ensure, as stated in Budget 2006, "...all government programs are effective and efficient, are focused on results, provide value for taxpayers' money and are aligned with the government's priorities and responsibilities." The issues raised by the Office of the Auditor General in this report are generally consistent with those that the government believes a new expenditure management system should address.

The new Expenditure Management System (EMS) will entrench responsible spending. It will require that all new and existing programs go through a systematic and rigorous examination. This will ensure that the government only approves funds that are actually needed to achieve measurable results in a way that is effective, and provides value-for-money on behalf of Canadians.

The EMS renewal is a critical building block for government-wide, results-based management and a stronger accountability regime. Important steps in the renewal process have already been taken, such as the *Federal Accountability Act* and the Management, Resources, and Results Structure Policy, but further work remains.

Chapter

2

Expenditure Management System in Departments

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Expenditure Management System in Departments

Main Points

What we examined

In the federal government, departments decide on the mix of resources that is appropriate to deliver programs efficiently and effectively within the amounts voted by Parliament and the policies issued by the Treasury Board.

We examined the Expenditure Management System in three selected departments: Agriculture and Agri-Food Canada, Canadian Heritage, and Public Works and Government Services Canada. We also carried out a survey of officials in ten other departments. We examined selected programs to determine whether the program managers had adequate funding over a long enough timeframe to deliver the program. We examined how departments reallocate resources—specifically, how they respond to central expenditure review—and how they comply with conditions set by the Treasury Board for funding. We also examined whether the Treasury Board Secretariat provides clear guidance on the use of Supplementary Estimates, whether departments follow the guidance, and how departments use the Supplementary Estimates process.

Why it's important

The Expenditure Management System touches everything the government does, since all government activities involve spending. A sound and effective system for managing spending is central to the government's ability to carry out its fiscal responsibilities, fund its programs, control spending, and report financial and performance information to Parliament and the public. A system that works well promotes efficient, responsible, and accountable government. Without a good system, nothing that individual departments and agencies can do will result in sound overall management of government spending.

Departments play a key role in the Expenditure Management System, with primary responsibility for managing the resources allocated to them and achieving the results expected of their programs.

What we found

- In the programs we looked at there were significant examples of funding that was not adequately aligned with what was needed to deliver the programs and achieve their objectives, in terms of the

amounts allocated, timeframes, and funding profiles (the distribution of funding over a period of time). This affected how the programs were delivered, including their ability to recruit and retain staff. Alignment problems and pressures of the annual appropriations process also led departments to rely on cumbersome ad hoc measures to meet spending commitments.

- The capacity to respond to some elements of government-wide reallocation exercises was insufficient in the three departments we examined. In the case of the 2004 Expenditure Review Committee exercise, they responded largely with financial information that was not adequately combined with information on performance. The lack of a systematic government approach to central expenditure reviews is an underlying cause of these problems.
- In recent years, an increasing proportion of spending items has appeared in Supplementary Estimates rather than in Main Estimates. This limits parliamentarians' opportunity to scrutinize the full range of proposed government spending. The Treasury Board Secretariat has recognized the need to consolidate spending items in the Main Estimates. However, little has been done to reduce departments' reliance on Supplementary Estimates. In addition, departments start to spend on items in the Supplementary Estimates using existing authorities but before Parliament has voted on the Estimates. This practice undermines parliamentary control of government spending and exposes program funding to the risk that Parliament might reduce or reject the Supplementary Estimates.

The government has responded. The government considers that the issues raised in the chapter are generally consistent with those that a new Expenditure Management System should address, including the objective of reducing the use of Supplementary Estimates. It is reviewing the issue of alignment in order to identify areas of improvement, and agrees with the need to redesign the process for central expenditure review.

Introduction

2.1 In the Expenditure Management System (EMS), ministers and their departments propose programs, related expenditures, and funding profiles (the distribution of funding over a period of time) to cabinet committees. They request funding approvals from Parliament, and subsequently report back to Parliament on what was achieved with the resources provided. When delivering programs and services, departments must work within their allocated budgets, comply with Treasury Board policies, and meet their legislated mandates.

2.2 This report's Overview of the Federal Government Expenditure Management System provides a description of the roles and responsibilities of the various institutions that are participants and stakeholders in the EMS. Chapter 1, Expenditure Management at the Government Centre, describes the role of the central agencies. The present chapter describes how departments and agencies participate in the Expenditure Management System.

2.3 The *Financial Administration Act* assigns specific responsibilities to Ministers and their deputies for the prudent management of resources. Department statutes assign responsibility to ministers for the "management and direction" of their departments. Treasury Board policy also requires departments to have appropriate management procedures in place to promote efficient and effective use of funds.

2.4 In this audit, we addressed selected key features of the role of departments in the EMS. In deciding on the appropriate mix of resources needed for program delivery, departments set objectives and determine program requirements. We examined the extent to which they align funding with program requirements. We looked at the response to reallocation requests from the centre of government, compliance with conditions set by Treasury Board, and the extent of use of Supplementary as opposed to Main Estimates.

2.5 To examine the role departments play in the Expenditure Management System in greater depth, we selected three departments—Agriculture and Agri-Food Canada, Canadian Heritage, and Public Works and Government Services Canada (Exhibit 2.1). These departments represent a cross-section of the federal government in terms of size and range of functions.

Exhibit 2.1 **Audited departments by expenditures, functions, and spending category**

Department	Gross expenditures (2004–05 in $ billions)	Functions	Spending category
Public Works and Government Services Canada	4.6	Supports the daily operations of nearly 140 federal departments and agencies by providing common services to government such as purchasing goods and services and providing office accommodations.	Mainly projects or procurement
Agriculture and Agri-Food Canada	3.4	Supports the security of the food system and the health of the environment, through policies and programs, as well as information, research and technology.	Mainly grants and contributions
Canadian Heritage	1.3	Supports Canadian heritage and culture through national policies and programs.	Mostly grants and contributions

Sources: Public Accounts of Canada 2005 (Volume II) and departments.

The role of the departments in the Expenditure Management System

2.6 Expenditure management in departments is tied to the annual budget cycle and also reacts to changing priorities throughout the year. The process that sustains it is multi-faceted.

2.7 Departments make a Treasury Board submission each year, asking the Treasury Board to approve their reference levels through the Annual Reference Level Update (ARLU) process. Departments provide detailed financial information for this process, which is purely technical. For most new and enriched program funding, the minister presents options to the appropriate Cabinet committee, in a memorandum that the department prepares.

Annual Reference Level Update — A process in which the Treasury Board decides on funding for the ongoing delivery of existing programs. A department's reference level is the amount of funding that the Treasury Board has approved for departments and agencies to carry out policies and programs for each year of the planning period.

2.8 Funding decisions may be announced in the budget of the Minister of Finance or in a separate government announcement, such as in a news release. These announcements reflect the choice of policy option, and typically do not provide details of program implementation or delivery. When a source of funds has been identified, the department prepares a submission to the Treasury Board.

2.9 The Treasury Board may approve the submission with conditions that departments must meet, including those required to secure continued funding. These conditions cover financial and non-financial matters, as well as approvals of certain spending authorities. The conditions may also involve other departments.

Business of Supply—The process by which the Government submits its projected annual expenditures for parliamentary approval.

2.10 The process for approval of proposed expenditures culminates in the parliamentary **Business of Supply**, which involves the scrutiny of proposed expenditures in the Main and Supplementary Estimates and the enactment of appropriations.

Focus of the audit

2.11 The objective of this audit was to determine whether the three selected departments—Agriculture and Agri-Food Canada, Canadian Heritage, and Public Works and Government Services Canada—had effective procedures to ensure that spending complied with direction from the centre of government and met program funding requirements.

2.12 Our approach included analyzing various documents (such as policies and the Treasury Board Secretariat's *Guide to Preparing Submissions*), examining files (including a sample of Treasury Board submissions and decisions), and meeting with representatives from the audited entities. We also conducted a survey of officials at ten other departments, in order to reach broader observations and conclusions.

2.13 More details on our audit objective, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Aligning a program's funding with its requirements

Alignment is important for expenditure management

2.14 Spending initiatives can involve large or small amounts, an ongoing or a temporary timeframe for funding, and a funding profile of equal or varying amounts each year. Determining the amount, the timeframe, and the funding profile is basic to designing an initiative or a program; all three factors are linked to the nature of the program objectives and how the program will meet its objectives.

2.15 What public programs are expected to do, how they work, and what constraints they face dictate the time and resources needed to meet their objectives. For example, a transfer payment program should reach identified recipients and allow them to use the money productively in line with program objectives. Support for scientific research needs to match the duration and nature of the research program. An information technology project must meet client needs and be responsive to a rapidly evolving technological environment.

2.16 Departments also operate within the constraints of annual appropriations. By determining the amount of funding that will meet program requirements each year, departments can avoid lapsing funds.

2.17 In this chapter, alignment refers to the extent to which the funding amount, timeframe, and profile match what the program requires for its implementation, delivery, and achievement of objectives. While alignment is important for good administration and effective delivery of a program to Canadians, it is not always fully achievable. There is therefore a need to assess the risks associated with a lack of alignment.

2.18 We examined alignment in the three departments through a file review of new spending, and through discussion of cases with the officials responsible for them. In our survey of ten other departments, we asked senior financial officers and program managers about the nature of the funding and alignment issues.

2.19 We expected departments to identify the appropriate timeframe and amount of funding for programs. We also expected that these amounts would be consistent with the requirements for program delivery, enabling the achievement of program objectives.

There are significant examples of alignment problems

2.20 Officials at ten departments—the three we focused on and seven from our survey—recognized the importance of alignment. They identified problems and sought solutions to them. Officials at the other three departments in our survey told us they were generally able to align funding with program requirements, because of stable year-to-year funding.

2.21 We found three types of alignment problems:

- temporary funding for ongoing programs,
- timeframes not set according to program requirements, and
- funding profiles not aligned with planned or actual spending.

2.22 **Temporary funding for ongoing programs.** We found significant examples in the three departments of ongoing programs with long-term objectives whose funding was either partially or entirely temporary.

2.23 Temporary funding does not in itself lead to a lack of alignment. Spending initiatives announced in budgets typically have three- or five-year timeframes. This does not cause inadequate alignment if

program requirements are temporary in nature. Funding is often approved for shorter periods of time to make it possible to assess a program's progress after a few years. However, temporary funding may not be desirable when programs have objectives that can only be achieved over the long term.

Tomorrow Starts Today—A Department of Canadian Heritage initiative, announced in 2001, that provides support for Canadian arts and culture through a set of programs that help to develop Canada's artists and promote Canadian cultural industries.

2.24 **Tomorrow Starts Today** is an initiative in the Department of Canadian Heritage currently involving expenditures of $860 million over five fiscal years, 2005–06 to 2009–10. It contains examples of ongoing programs with short-term funding. It enhanced a number of earlier Heritage programs when it was launched as a three-year initiative in 2001. Tomorrow Starts Today has since been renewed twice: first in 2003, for one year; and then in 2005, for five years (to 2009–10). The Department has sought ongoing funding for these programs. Senior officials have acknowledged that there are problems with sunsetted (time-limited) funding, and have stated that unless programs are truly temporary, not knowing whether the program will be renewed makes it more difficult to achieve the desired results.

2.25 **Timeframe not set according to program requirements.** In several of the files we examined, we found this alignment problem. In these cases, the government had set timeframes in announcements, but did not necessarily determine timeframes by the requirements of the program.

Agricultural Policy Framework—A federal, provincial, and territorial strategy for prosperity and profitability in the agricultural sector, made up of five elements

- business risk management,
- food safety and quality,
- science and innovation,
- environment, and
- renewal.

2.26 We found temporary funding and timeframe problems in Agriculture and Agri-Food Canada's **Agricultural Policy Framework** (APF), which came into force in 2003 as a $5.2 billion, five-year commitment (fiscal years 2002–03 to 2007–08). The APF, a federal-provincial-territorial cost-shared agreement made up of several new programs, signalled a new national approach to agriculture with long term objectives. By its third year in 2005, APF implementation reflected delays in certain programs and initiatives such as food safety and quality. Delays were caused by a number of factors such as the design and launching of programs and the implementation of delivery mechanisms, including complex delivery by other jurisdictions and lower than expected participation rates. Some of these issues were known when the APF was negotiated; others would have been difficult to predict. Overall, the choice of a five-year framework has not correlated well with a number of program requirements.

2.27 **Funding profiles not aligned with planned or actual spending.** This major problem was cited by officials at six of the ten departments in our survey. We also found it in three of the files we examined. Respondents to our survey raised the following points:

- A number of obstacles can delay or impede program implementation, such as negotiations with third party stakeholders because of uncertainty as to the availability and amount of funds that may eventually be released by Treasury Board.
- If the funding profile does not match program requirements, or if delays occur in getting Treasury Board approval, the department normally requests a reprofiling of funds (reprofiling changes the funding profile by moving funds to later years). Since the Department of Finance approves or denies such requests, this causes extra uncertainty for program continuity.
- There is a constant need to change designated funding profiles. Program requirements are continually shifting, often because of factors beyond the department's control.
- Reprofiling of funds is normally requested mid-year, which requires program managers to estimate potential lapse. Most managers find it difficult to estimate these amounts. This eventually leads to the lapsing of large amounts of time-limited funding and restricts the department's ability to meet program objectives.
- Approval processes take longer than anticipated, resulting in delayed program start-up. Treasury Board submissions must reflect funding profiles as presented in policy approvals even though forecasts about cash flows may have changed.
- Even when it is virtually certain that expenditure will ramp up over time, the funding profile for new budget initiatives is typically straight-lined, beginning in the first year of implementation.

Alignment problems have a significant impact

2.28 Alignment problems have had a significant impact on program delivery, and have also led departments to rely on ad hoc measures to meet spending commitments. In the following paragraphs we present examples from the three departments, taken from our file review and other cases we examined. Five other departments responded to our survey with examples related to human resources management and program effectiveness.

2.29 One example of effects on delivery to Canadians was found in contribution programs intended to support multi-year projects. Because it was uncertain whether the Cultural Spaces Canada program (part of the Tomorrow Starts Today initiative) would be

Cultural Spaces Canada—This program focuses on repairing and upgrading arts and heritage facilities across Canada

renewed on a long-term basis, Canadian Heritage was unable to commit funding for multi-year projects in the last two years of the initial five-year program. The Budget 2005 announcement of funding for Tomorrow Starts Today and Cultural Spaces Canada until the end of 2009–10 should rectify the situation.

2.30 Uncertainty also led to a number of administrative problems, such as the need to continually reassess program priorities and funding. On an ongoing basis, more than half of the funding for some of the Tomorrow Starts Today programs was not secure. For example, Canadian Heritage applied a funding ratio (50 percent temporary and 50 percent permanent) to the **Canadian Memory Fund** for the years in which that program's funding was not assured. If temporary funding were interrupted or significantly reduced, individual programs would not be dropped. Instead, the funding for the entire Tomorrow Starts Today initiative would be reviewed. This created additional planning and administrative burdens on program management staff, and also required complex projects to be completed in one year. In the **National Water Supply Expansion** program (Agriculture and Agri-Food Canada), funds were moved into the final two years of the program so that multi-year projects could be completed by that time. The program involved expenditures of $60 million over four fiscal years, 2002–03 to 2005–06, as part of the Agricultural Policy Framework.

The **Canadian Memory Fund** makes available on the Internet, in both official languages and free of charge, key Canadian cultural collections held by federal institutions.

The **National Water Supply Expansion** program is administered by the federal government, in agreement with, and with additional contributions by, provincial governments across Canada. The program helps the agriculture community develop and enhance agricultural water supplies.

2.31 We found examples of alignment problems affecting human resources management. At Canadian Heritage, Tomorrow Starts Today programs have hired specialized staff on a temporary basis. It has proven difficult to recruit and retain staff. The problem is more acute in the regions, where there is limited ability to reassign indeterminate staff when temporary programs end. We found comparable problems in Public Works and Government Services Canada, where the **Exhibitions** program had a 30 percent annual turnover in staff, and the **Industrial Security** program also had recruitment and retention problems.

Exhibitions—A Public Works and Government Services Canada (PWGSC) program that coordinates federal participation in fairs and exhibitions. PWGSC develops, manages, and adjusts the Exhibitions program in consultation with institutions and various stakeholders. It oversees the program's planning, logistics, media and public relations, database management, and evaluation activities.

Industrial Security—A program established by the Government of Canada to safeguard classified and protected Canadian, NATO and foreign information and assets entrusted to private sector organizations as a result of participation in contractual and/or project program requirements.

2.32 **Secure Channel** is a Public Works and Government Services Canada initiative that provides a major example of reliance on "cash managing" as a result of alignment problems. Secure Channel cost $400 million to build and was put into production in 2004. Over five fiscal years, beginning in 2000–01, the department has been cash managing Secure Channel's ongoing operational funding until the funding is eventually recovered through the Treasury Board submission process. For example, in 2005–06, cash management amounted to $126 million. Over a sustained period, cash managing can cause

Secure Channel—An Internet pathway with a high level of security through which individuals and businesses communicate with the government.

distortions, since the funds must come from other sources within the department. It is an ad hoc approach to program funding.

System inflexibility weakens alignment

2.33 We asked what causes weak alignment of funding with program requirements. Officials in the three departments, as well as those responding to our survey, told us that a major cause of alignment problems is inflexibility in the Expenditure Management System.

2.34 Chapter 1 of this Report discusses problems created when funding allocations from the government centre do not appropriately align with program requirements. What we heard from the three departments that we audited raises the same issues.

2.35 It is difficult to change key approved policy options at the time of the program implementation, even when there is good reason to do so. In the files we examined, and in the interviews we conducted, it was clear that most decisions on the amount, the timeframe, and the funding profile were taken at the stage of the Memorandum to Cabinet. However, issues of program design were often unclear at that early stage. When circumstances changed, including cost increases and unforeseen delays, the Treasury Board Secretariat generally did not allow departments to use the Treasury Board submission process to change the amount, the timeframe, or the funding profile.

2.36 The Secretariat and the Department of Finance require adjustments to funding profiles to be made through an Annual Reference Level Update submission for reprofiling. This provides an opportunity to balance increases and decreases in program funding across government, as a way of managing the fiscal framework.

2.37 Departments also face the constraints of annual appropriations. With the exception of limited carry-over provisions, unspent funds lapse at the end of a fiscal year and are no longer available to meet program needs in a subsequent year.

2.38 We noted significant lapsing of funds in fiscal years 2003–04 and 2004–05 in connection with the Agricultural Policy Framework (APF). In the case of the APF, the lapsed funds were reprofiled to later years based on special arrangements with central agencies, but this took more than a year to arrange.

2.39 The existing process for changing these decisions is cumbersome and unresponsive to varying circumstances. We noted a number of cases where changes in the funding profile were required due to

circumstances beyond the departments' control. The reprofiling process was time-consuming and tied to a fixed schedule, often making it difficult to get the changes when needed, prior to program implementation.

2.40 For example, funding for **Surplus Federal Real Property for Homelessness** (a Public Works and Government Services Canada initiative), was distributed equally over the three years of the program ($3 million each year). However, that funding profile did not match program requirements, which led to a reprofiling of all the funding to the last year. The department attempted without success to change the funding profile at the Treasury Board submission stage. Similar inflexibility arose in the case of the funding profile for the **Advancing Canadian Agriculture and Agri-Food** program. The funding for this program was $240 million over five fiscal years, from 2004–05 to 2008–09.

Surplus Federal Real Property for Homelessness compensates federal departments and agencies at market value for surplus properties, and transfers them at a nominal cost to community organizations, the not-for-profit sector and other orders of government for projects to help alleviate and prevent homelessness.

Launched in April 2004 as a successor to the Canadian Adaptation and Rural Development Fund, the **Advancing Canadian Agriculture and Agri-Food** program will continue its predecessor's approach to funding projects at the national, multi-regional, and regional level.

There is a need for more risk assessment

2.41 There are significant risks to the amount and timing of funding when there is a failure to adequately align program funding with program requirements. For example, Agriculture and Agri-Food Canada must assess such risks when it estimates the amount of funding needed for farm income support programs under the Agricultural Policy Framework, particularly if it does not know how much demand there is for the program.

2.42 We expected departments to identify potential risks to the amount and timing of funding that may affect the achievement of program objectives.

2.43 For Treasury Board submissions, the Secretariat's *Guide* calls upon departments to provide specific funding details and a clear rationale for the resources to be spent each year. Among the questions that the Secretariat's analysts ask is whether departments have assessed the risks to the amount and timing of their funding, and whether they have a plan to manage them. The risk profile for Treasury Board submissions identifies financial risks, including expenditures that are likely to exceed funding.

2.44 We noted that the Secretariat and corporate services in the three departments provided program managers with guidance on high-level risk assessment. However, in the majority of the files we reviewed, there was no indication that departments considered risks related to the amount and timing of funding in the Treasury Board submission

process. In many of the cases, the treatment of risks was at a broader level, lacking specific analysis of program-level risks with respect to the funding amount, timeframe, and profile. Such assessments were not a requirement in a submission.

2.45 Departments told us that these risks are generally assessed at the Memorandum to Cabinet stage, when the Cabinet committee decides whether to approve the funding. In view of the extent of alignment problems, there is a need to continuously assess financial risk as program details become more clearly defined, as an integral part of the Treasury Board submission process.

2.46 **Recommendation.** The Treasury Board Secretariat should assess risks related to alignment issues in the Treasury Board submission process.

The government's response. As stated in the response to the recommendation of paragraph 1.64 of Chapter 1, the issue of alignment is being reviewed in order to identify areas for improvement.

Greater attention to alignment is needed

2.47 In the three departments, officials emphasized the role of the central agency approval processes in ensuring alignment. However, the officials consider it essential that program funding meet program requirements. They want to find ways to ensure greater alignment. In particular, all three departments have improved their capacity to know where the money goes. For example, at the start of fiscal year 2006–07, Agriculture and Agri-Food Canada established a baseline for tracking expenditures to sources of funds.

2.48 Officials responding to our survey of ten departments suggested a number of other actions that would help to ensure greater alignment. These included better costing procedures, improvements in cash management and reprofiling practices, as well as more involvement by the senior financial officer.

2.49 In announcing a review of the Expenditure Management System in Budget 2006, the government sought to ensure that all programs were aligned with its priorities and responsibilities. Our findings underscore the need for greater attention to alignment to meet responsibilities for program delivery.

2.50 **Recommendation.** The central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office), in consultation with senior financial officers, should

- investigate the causes of lack of alignment of program funding, timeframe, and funding profile with program requirements; and
- develop an action plan for remediation of these problems, to be carried out along with the government review of the Expenditure Management System.

The government's response. As stated in the response to the recommendation of paragraph 1.64 of Chapter 1, the issue of alignment is being reviewed in order to identify areas for improvement.

Responding to central expenditure review

2.51 The capacity of departments to allocate and reallocate resources based on changing priorities is a major part of the Expenditure Management System. In order to examine this capacity in the three departments, we focused on the 2004 Expenditure Review Committee exercise.

2.52 We expected the departments to have effective processes and procedures to review their existing spending in order to adequately respond to requests for reallocation from central agencies.

2.53 The Expenditure Review Committee of Cabinet, which was created in 2003 as part of an undertaking to review all government programs, launched an exercise in September 2004 that required departments to identify low priority items that could be curtailed or eliminated to generate permanent savings. It was tied to Budget 2005 and carried out under budget secrecy. It required departments to work under tight deadlines, preparing proposals that had to meet criteria based on both financial and non-financial information.

2.54 Through the Expenditure Review Committee exercise, Budget 2005 identified $11 billion in savings, to be achieved over five years. The government also committed itself to an annual spending review as part of the yearly budget cycle, intended to make the reallocation process an ongoing part of the Expenditure Management System.

Departments need to build up their capacity to respond to future expenditure reviews

2.55 We examined the way the three departments responded to the Expenditure Review Committee tests related to value-for-money, achieving results, and efficiency. We did not look at more subjective tests, such as opportunities for realignment of programs to the provinces, or at horizontal ones, such as those involving other departments.

2.56 The departments faced a challenging need for secrecy and tight deadlines, which limited their ability to respond. Each department had established an ad hoc coordination body, made up of senior officials, which led the department response.

2.57 We found some positive elements in department responses to the Expenditure Review Committee. Departments were able to identify savings, and responded to the government centre with an analysis and rationale for them. They used some performance information, including benchmarking information and program evaluations. For example, Canadian Heritage reviewed program initiatives to verify their link to the core mission and strategic objectives of the department. Their response to the Expenditure Review Committee included the review of recent internal audits and program evaluations.

2.58 However, we found that the departments were not well prepared to carry out the Expenditure Review Committee tests. They had not developed the capacity necessary to make permanent cuts in programs. Overall, the analysis was largely based on financial information. While in some cases, departments did make use of non-financial information to substantiate their decisions on value-for-money, achieving results, and efficiency, they did not generally do this.

2.59 What departments needed for these tests was partially available. Just prior to the launching of the Expenditure Review Committee exercise, Public Works and Government Services Canada implemented improvements in costing, based on a review of departmental expenditures. The development of the Agricultural Policy Framework in 2002 provided Agriculture and Agri-Food Canada with program information that was useful in the Expenditure Review Committee exercise. Canadian Heritage and Agriculture and Agri-Food Canada made use of program evaluations.

2.60 Although all three departments made major reallocation and reduction commitments, they did not adequately document what had been learned from the Expenditure Review Committee exercise. This could reduce the departments' capacity to effectively respond to future government spending reviews.

2.61 In our view, the lack of a systematic approach is an underlying cause of the problems with central expenditure reviews. There is a need to better understand the issues, and how they relate to program performance. This requires encouragement and support from central agencies.

2.62 In Budget 2006, the government announced that the President of the Treasury Board will identify savings of $1 billion in 2006–07 and

in 2007–08. This, together with the review of the Expenditure Management System, provides an opportunity to redesign the process for central expenditure review and develop department capacity to respond to it more effectively.

2.63 Recommendation. The central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office), in consultation with senior financial officers, should

- redesign the process for central expenditure review, in conjunction with the government review of the Expenditure Management System; and
- ensure that departments improve their capacity to respond to future central expenditure reviews.

The government's response. Agreed. The implementation of systematic reviews of ongoing programs will address this.

Complying with Treasury Board conditions

2.64 Departments and agencies are subject to two broad levels of control over the funds that form part of their approved budgets. Parliament exercises control through appropriations, and the Treasury Board exercises control on behalf of the executive, through a variety of mechanisms. These include controlling departments' approved funding levels by means of specific conditions attached to individual Treasury Board decisions. Treasury Board has four options when considering a submission: approve; not approve; approve with conditions; or defer to another meeting. Treasury Board can impose different types of conditions on Treasury Board submissions (Exhibit 2.2). For example, a portion of a payment from a contribution program may not be released to a department until it meets the reporting requirements.

Exhibit 2.2 Examples of Treasury Board conditions for departments

Submission # 1	Submission # 2
• Provide a revised trust agreement to the Treasury Board on time, otherwise they will establish frozen allotments. • Provide the Business Plan to Treasury Board by a set deadline. • Finalize an umbrella Results-based Management and Accountability Framework and Risk-Based Audit Framework.	• Undertake a study to decide the full cost of accommodating staff. • Evaluate both the benefit and feasibility of purchasing the building and report back to Treasury Board Secretariat before a set deadline. • Accommodate all administrative staff across the government in a consistent manner.

Source: Treasury Board Secretariat

2.65 Once the Treasury Board approves a submission with a condition, departments are responsible for fulfilling that condition. A condition may take months to fulfill. We expected that the departments would ensure they respect and fulfill funding conditions by

- tracking conditions and related requirements,
- monitoring the fulfillment of the conditions, and
- taking appropriate steps to address compliance issues as they arise.

Department practices allow adequate monitoring of conditions

2.66 Although there are variations among them, all three departments have a centralized process for monitoring and tracking conditions (Exhibit 2.3). Typically, there is a unit under corporate finance that has a coordinating role in tracking and monitoring conditions. The unit is responsible for updating the database with new information and reporting to senior department officials on the status of compliance. They work with program managers to monitor conditions. They can also challenge the adequacy of the department's response to those conditions, to ensure that the Treasury Board Secretariat is satisfied with the responses related to conditions requiring follow-up.

2.67 We selected a sample of Treasury Board decisions that had attached conditions for our three departments. We found that all three departments have adequate procedures allowing them to comply with funding conditions.

Exhibit 2.3 How departments monitor funding conditions

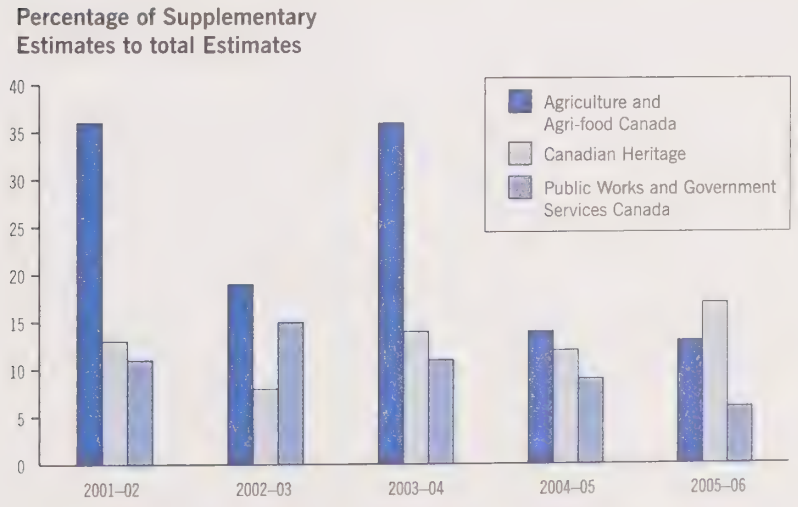
Monitoring systems	Information tracked	Monitoring process
• Registry database • Condition reporting database/file system	• Date and Treasury Board number • Treasury Board submission title • Programs and branches • Recap or edit of conditions • Status and follow-ups	• Department registers the conditions centrally. • Responsible unit updates compliance with conditions frequently. • Department follows up on outstanding conditions with programs and branches by informing responsible senior managers. • Department updates senior officials on status, consulting with Treasury Board Secretariat program sector analysts and reviewing and coordinating documents, sending them to Treasury Board Secretariat to fulfill conditions. • Department registers responses and reports to senior officials.

Using Supplementary Estimates

2.68 The government cannot proceed with its spending plans without parliamentary approval. Supplementary Estimates directly support supply bills. They identify the spending authorities (votes) and amounts to be included in subsequent appropriation acts. Supplementary Estimates are normally tabled twice a year, the first in November (Supplementary Estimates A) and the second in March (Supplementary Estimates B). Appropriation acts are passed in December and March, respectively. Exhibit 2.4 shows the extent to which the three departments used Supplementary Estimates between 2001 and 2006.

2.69 As described in the Overview and Chapter 1, across the government in recent years a rising proportion of spending items has appeared in Supplementary rather than Main Estimates (Chapter 1, Exhibit 1.1). We found that the process for Supplementary Estimates was technical and that the main reason for including items was timing. Reliance on Supplementary Estimates means that Main Estimates have become less meaningful because they no longer show the complete picture of planned spending. In our view, more complete Main Estimates would provide an opportunity for parliamentarians to scrutinize the full range of government expenditure.

Exhibit 2.4 Reliance on Supplementary Estimates varies by year and by department



Supplementary Estimates (A) 2005-06 were tabled but not approved by Parliament.

2.70 According to the Treasury Board Secretariat, the purpose of Supplementary Estimates is to seek parliamentary approval of

- changes (usually increases) to existing appropriations or for new appropriations;
- new or modified vote wording;
- increases to existing grants or the establishment of new grants when these require specific parliamentary approval;
- transfers of funds from one vote to another, either within an organization or between organizations; and
- specific spending authorities such as loan guarantees, debt write-offs, or revolving fund write-offs.

Supplementary Estimates also inform Parliament of significant changes to statutory spending, for example, public debt costs and federal-provincial transfers.

2.71 Accordingly, we expected that

- Treasury Board Secretariat rules and guidelines governing the use of Supplementary Estimates would be clearly established, communicated, and understood by department officials;
- the Treasury Board Secretariat would have in place effective processes and procedures to monitor compliance with the rules governing the use of Supplementary Estimates;
- departments would have processes and procedures in place to ensure that they comply with the rules and guidelines governing the use of Supplementary Estimates.

Guidelines for preparing Supplementary Estimates were clear and departments complied with them

2.72 Exhibit 2.5 describes the process followed to prepare Supplementary Estimates.

2.73 Although the Secretariat and departments each have a role to play in getting the Supplementary Estimates approved by Parliament, all stages of the process require ongoing consultations between the Treasury Board Secretariat and the departments.

2.74 For all Supplementary Estimates that are going to be published, the Secretariat prepares detailed instructions listing eligible items and items to be excluded. Over the past years, some changes have been

made to the instructions to reflect, for example, new requirements for reporting Supplementary Estimates to Parliament. We reviewed the guidelines and concluded that they were adequate.

Exhibit 2.5 Typical process of preparing Supplementary Estimates (A)

Date	Departments	Treasury Board Secretariat
Early August		Secretariat mails call letters for Supplementary Estimates and expenditure status reports to departments' Senior Financial Officers. These documents list the items eligible for inclusion in the Supplementary Estimates and those that may still require Treasury Board approval.
	Detailed instructions list the eligible items to be included in the Supplementary Estimates. The instructions also list the items that should be excluded. A template worksheet is available to departments to help them prepare the Supplementary Estimates.	
	Finance branches in departments contact the other branches about completing the template worksheet. The branches decide whether to request additional funding in the Supplementary Estimates, or to "cash manage" instead. An explanation of the requirement must also be provided. In addition to the items listed, the departments can request Treasury Board approval for other non-controversial items to be included in the Supplementary Estimates.	Secretariat analysts are available to help the departments complete this work.
Early September	Deadline for sending Supplementary Estimates submissions and worksheets to the Secretariat.	
		Secretariat analysts review the departments' Supplementary Estimates submissions and worksheets. They verify the accuracy of the items included. They ensure that amounts requested on the spreadsheet match the amount approved in the Treasury Board decision and are in the correct vote. If the item has not been approved, they have to determine what changes will increase its chances for approval.
Mid-September		Deadline in this period for Treasury Board analysts to submit the information required to get approval for items not already approved.
Early October		Last Treasury Board meeting to get items approved for inclusion in the Supplementary Estimate.
		Secretariat analysts ensure that the departments have the required spending authorities including transfers between departments. They finalize page proofs and prepare briefing notes for the President of the Treasury Board.
Mid- to end October	Departments must have the proofs that are sent by the Secretariat signed by their Minister.	Secretariat sends the proofs to the departments.

2.75 We examined the processes and procedures used by the three departments to ensure that they comply with the rules and guidelines set by the Secretariat, and we concluded that these were adequate.

Little is being done to limit reliance on Supplementary Estimates

2.76 The Treasury Board Secretariat recognizes the need to consolidate spending items in the Main Estimates and to minimize the repetitive use of items in the Supplementary Estimates.

2.77 However, we did not find anything related to this in their call letter forms, or in their guidelines for preparing the Annual Reference Level Update, the Main Estimates, and the Supplementary Estimates.

2.78 We have also reviewed the training material on Supplementary Estimates for Secretariat program analysts. However, the training material did not offer instruction as to when they must question whether an item belongs in the Main Estimates, instead of in the Supplementary Estimates.

2.79 Items that will appear in the Supplementary Estimates must first have been approved by the Treasury Board (Exhibit 2.5). We noted that the timing of Treasury Board approval and the need for the money within the current fiscal year dictate whether parliamentary approval will be sought through the Supplementary Estimates. Secretariat officials told us that after challenging submissions in the approval process, they do not challenge the inclusion of items in the Supplementary Estimates.

2.80 The timing of the Budget and the Main Estimates is a key factor in the use of Supplementary Estimates. The deadline for inclusion of items in the Main Estimates is usually months in advance of the Budget. For example, new announcements in Budget 2005, for spending in fiscal year 2005–06, meant that the only way to get parliamentary approval for spending in that fiscal year is through the Supplementary Estimates, the deadline for inclusion of items in Main Estimates having passed. Although a Treasury Board submission may be approved in October—just before the deadline for inclusion of items in the Main Estimates—that does not mean it will be included in the Main Estimates. If a department needs funding for the current fiscal year, it can only get parliamentary approval through Supplementary Estimates.

2.81 We noted that a few items in the Supplementary Estimates (B) 2004–05 reappeared in the Supplementary Estimates (A) 2005–06. The departments wanted to obtain funding for those items during the

2004–05 and 2005–06 fiscal years. Because the deadline for inclusion of items in the 2005–06 Main Estimates had passed, the items were included in the next year's Supplementary Estimates.

2.82 Timing might explain why some items appear in the Supplementary Estimates in a given year, but we also wanted to know whether timing could explain their regular reappearance year after year in the Supplementary Estimates. Our review shows that items reappear for different reasons such as for ongoing programs without a permanent source of funding, and for different projects submitted each year under the same title.

2.83 Our audit work indicates that unless government brings about changes to the Expenditure Management System, many items will still be included in Supplementary Estimates because of the system's timing and the necessity of obtaining funding in the current fiscal year. We also found that the Treasury Board Secretariat does not perform regular and thorough reviews of items included in the Supplementary Estimates. In our view, effectively challenging the reliance on Supplementary Estimates would improve the Expenditure Management System.

Departments are spending existing funds on Supplementary Estimates items

2.84 Supplementary Estimates seek authority for spending initiatives that are announced in the Budget, or that are announced subsequently, outside the Budget cycle, and that Parliament will be asked to approve in an appropriation act. In many instances, several months elapse between the initial approval of the funds requested in a Treasury Board submission and the subsequent approval by Parliament. Departments then face two choices: they can wait for parliamentary approval before spending or they can start spending if they think they can manage the risk that parliamentary approval may not come. The latter practice is a form of cash management. While waiting for parliamentary approval, the latter departments can use existing approvals to fund a program or activity, if the wording of that existing spending authority is broad enough. In a regular year, with Supplementary Estimates (B) approved late in March, most of the spending occurs before year-end (March 31). Departments are told by the Treasury Board Secretariat that they are accountable for their spending.

2.85 In the three departments, and in eight others covered by our survey, officials cited instances where spending started after Treasury Board approval and a risk assessment, but before appropriations for Supplementary Estimates had been passed by Parliament, in order to provide programs and services for Canadians.

2.86 If earlier appropriation acts have provided sufficient authority for program spending, then further spending before the approval of a Supplementary Estimate is not a compliance problem. It does raise two concerns, however. First, Parliament has the right to examine proposed expenditures before departments make them, which cannot be done if departments spend prior to approval. Second, the Treasury Board has indicated to departments that they face a supply risk, a risk of having insufficient funds, should Parliament exercise its power to reduce or "negative"(not approve) a vote (an Estimate). In such cases, departments will have used money allocated to other requirements for spending items that they listed in their Supplementary Estimates. Existing programs may suffer.

2.87 We expected the rules governing Supplementary Estimates to be clear and to be followed by departments. The Treasury Board Secretariat sends a call letter warning the departments of a funding supply risk if they start spending on Supplementary Estimates items before parliamentary approval. In the three departments, officials told us that there was pressure to implement programs in a timely way, following budget or government announcements and Treasury Board approval. Because of those mixed messages, they faced a dilemma: to spend before parliamentary approval or delay program delivery. In a number of cases, they proceeded with program delivery and managed the associated risks. This course of action undermines parliamentary control over public spending, particularly for Supplementary Estimates (B).

2.88 **Recommendation.** In relation to the Supplementary Estimates

- the central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office) should develop an action plan for consolidating spending items in the Main Estimates, in order to limit the use of Supplementary Estimates;
- the Treasury Board Secretariat should ensure that departments respect the parliamentary control framework; and
- these measures should be taken along with the government review of the Expenditure Management System.

The government's response. Main Estimates remain the primary vehicle for setting out government spending for review by Parliament. Reducing the use of Supplementary Estimates is one of the objectives in the new Expenditure Management System.

The Treasury Board Secretariat is very clear in its guidance to departments as well as Treasury Board decision letters that Treasury Board approval does not mean authority to spend since Parliament has

not provided spending authority. Treasury Board Secretariat has, particularly in recent years, been very pro-active in cautioning departments. The call letter sent to departments for Supplementary Estimates states,

> "While the Treasury Board, as part of the executive arm of government, has authority to approve departmental spending proposals, such approval does not constitute the authority to spend, but only to seek spending authority through the Estimates. Departments face a supply risk if they start to spend in advance of parliamentary approval. Parliament can reduce the amounts contained in the supply bills, and has done so in the recent past. If departments do elect to start spending in advance of parliamentary approval of Supplementary Estimates supply, even for initiatives announced in the Budget, they must manage this risk by being prepared to reallocate funds from existing programs to make up the potential shortfall."

Conclusion

2.89 In this audit we examined the role of departments in the Expenditure Management System. We selected for detailed audit three departments that represent a cross-section of the federal government. We also carried out a survey among officials at ten other departments.

2.90 Some parts of the system are working well in the three departments we examined. For example, the departments are able to track and monitor their compliance with conditions imposed by Treasury Board in funding decisions. However, there are notable weaknesses. In particular, there were significant examples of funding that was not adequately aligned with program requirements, which had a negative effect on program delivery. This problematic lack of alignment was primarily due to inflexibility in the system. Other such problems were the lack of a systematic approach to central expenditure review exercises, and the increasing proportion of spending items appearing in Supplementary Estimates rather than Main Estimates.

2.91 Although departments can take remedial measures in several areas, our conclusion is that there is a need for improvements to be carried out across the system, along with the government review of the Expenditure Management System, and led by the Treasury Board Secretariat and the other central agencies.

About the Audit

Objectives

Our general objective was to determine whether departments have effective procedures to ensure that spending complies with direction from the government centre and meets program funding requirements.

We examined whether program funding aligns with program requirements, looking specifically at

- the extent to which department requests for funding adequately reflect the financial requirements and timing of the program, and
- the impact of the timeframe of funding on departments' abilities to effectively manage department programs and to achieve program objectives.

We also examined

- allocation and reallocation issues, looking specifically at whether departments adequately respond to expenditure review exercises;
- the funding conditions under which allocation and reallocation occur; and
- the use of Supplementary Estimates, looking specifically at the adequacy of Treasury Board Secretariat oversight concerning the use of Supplementary Estimates, and the extent to which departments comply with the rules and guidance governing the use of Supplementary Estimates.

Scope and Approach

We selected three departments for our audit work: Agriculture and Agri-Food Canada, Canadian Heritage, and Public Works and Government Services Canada. These departments represent a cross-section of the federal government, in terms of size and range of functions. Treasury Board Secretariat was also part of our audit.

Our approach included analyzing various documents (such as policies and guidelines), examining files (including a sample of Treasury Board submissions and decisions), and meeting with representatives from the audited entities. We also conducted a survey of ten other departments and agencies in order to reach broader observations and conclusions. These departments and agencies are: Canadian International Development Agency, Canada Revenue Agency, Environment Canada, Fisheries and Oceans Canada, Indian and Northern Affairs Canada, Industry Canada, Natural Resources Canada, Human Resources and Social Development Canada (Service Canada only), Transport Canada, and Veterans Affairs Canada. We did not audit the responses to our survey.

Criteria

We expected that departments

- would identify an appropriate timeframe and amount of program funding that is consistent with requirements for program delivery, and that will enable the achievement of program objectives;

- would identify potential risks related to the amount and timing of funding that could affect the achievement of program objectives;
- would have effective processes and procedures for reviewing their existing spending, enabling them to respond adequately to requests for reallocation from central agencies; and
- would respect and fulfill funding conditions by being aware of all conditions and related requirements, monitoring the fulfillment of the conditions, and taking appropriate steps to comply whenever required.

We also expected that

- Treasury Board Secretariat rules and guidance governing the use of Supplementary Estimates would be clearly established, communicated, and understood by department officials;
- the Treasury Board Secretariat would have in place effective processes and procedures to monitor compliance with the rules governing the use of Supplementary Estimates; and
- departments would have processes and procedures in place to ensure that they comply with the rules and guidelines governing the use of Supplementary Estimates.

Audit work completed

Audit work for this chapter was substantially completed in June 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 2. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Government's response
Aligning a program's funding with its requirements	
2.46 The Treasury Board Secretariat should assess risks related to alignment issues in the Treasury Board submission process. **(2.14–2.45)**	As stated in the response to the recommendation of paragraph 1.64 of Chapter 1, the issue of alignment is being reviewed in order to identify areas for improvement.
2.50 The central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office), in consultation with senior financial officers should • investigate the causes of lack of alignment of program funding, timeframe, and funding profile with program requirements; and • develop an action plan for remediation of these problems, to be carried out along with the government review of the Expenditure Management System. **(2.14–2.49)**	As stated in the response to the recommendation of paragraph 1.64 of Chapter 1, the issue of alignment is being reviewed in order to identify areas for improvement.

Recommendation	Government's response
Responding to central expenditure review	
2.63 The central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office), in consultation with senior financial officers, should • redesign the process for central expenditure review, in conjunction with the government review of the Expenditure Management System; and • ensure that departments improve their capacity to respond to future central expenditure reviews. **(2.51–2.62)**	Agreed. The implementation of systematic reviews of ongoing programs will address this.
Using Supplementary Estimates	
2.88 In relation to the Supplementary Estimates • the central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office) should develop an action plan for consolidating spending items in the Main Estimates, in order to limit the use of Supplementary Estimates; • the Treasury Board Secretariat should ensure that departments respect the parliamentary control framework; and • these measures should be taken along with the government review of the Expenditure Management System. **(2.68–2.87)**	Main Estimates remain the primary vehicle for setting out government spending for review by Parliament. Reducing the use of Supplementary Estimates is one of the objectives in the new Expenditure Management System. The Treasury Board Secretariat is very clear in its guidance to departments as well as Treasury Board decision letters that Treasury Board approval does not mean authority to spend since Parliament has not provided spending authority. Treasury Board Secretariat has, particularly in recent years, been very pro-active in cautioning departments. The call letter sent to departments for Supplementary Estimates states, "While the Treasury Board, as part of the executive arm of government, has authority to approve departmental spending proposals, such approval does not constitute the authority to spend, but only to seek spending authority through the Estimates. Departments face a supply risk if they start to spend in advance of parliamentary approval. Parliament can reduce the amounts contained in the supply bills, and has done so in the recent past. If departments do elect to start spending in advance of parliamentary approval of Supplementary Estimates supply, even for initiatives announced in the Budget, they must manage this risk by being prepared to reallocate funds from existing programs to make up the potential shortfall."

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Chapter 3
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to the House of Commons

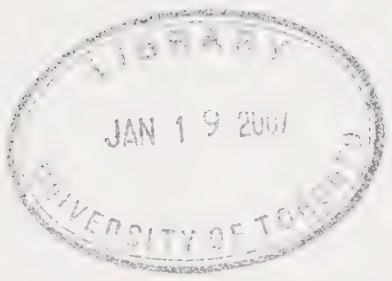
NOVEMBER

Chapter 3

Large Information Technology Projects

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.



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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-3E
ISBN 0-662-44367-5

Chapter

3

Large Information Technology Projects

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Large Information Technology Projects

Main Points

What we examined

The many large information technology projects now under way across the federal government are no longer only about introducing new computer hardware, software, or systems. They are meant to help departments change the way they do business—for example, by introducing new processes and modernizing work practices.

We examined a sample of seven large IT projects from four perspectives:

- **Governance.** Did the processes used by the government to approve and manage large IT projects increase the project's likelihood of success?
- **Business case.** Did the department or agency proposing the project clearly define the business needs it expected the project to meet?
- **Organizational capacity.** Did the department have people with the needed skills and experience to manage a large IT project and did the organization have the ability to use all of a system's capabilities to improve the way it does business?
- **Project management.** Did the department follow accepted best practices in managing the project?

We also attempted to examine the role the Treasury Board Secretariat played in the challenge and oversight of these large information technology projects. However, we could not audit this role because we were denied access to most of the information and analysis it collects and prepares. The government has effectively imposed a limitation on the scope of the Auditor General's examination.

Why it's important

Few departments today can deliver their business without the support of their IT. Governments must deliver successful IT projects if they are to provide their services to the public economically, efficiently, and effectively. Large IT projects are becoming more complex than ever and often involve a growing number of players across government.

In the last three years, the federal government has approved funding of $8.7 billion dollars for new business projects with significant use of IT.

Despite their importance to departments, large IT projects have had a history of overspending, delays, performance shortfalls, and abandonment after major investments. Understanding why some projects have succeeded while others have failed would better position the government to plan and manage IT projects for success, maximizing the benefits of its investment in information technology by giving departments effective tools for delivering services.

What we found

- Only two of the seven projects we looked at: the 2006 Census Online and My Account, My Business Account projects met all of our audit criteria for well-managed projects.
- Overall, the government has made limited progress since our last audit of IT projects in 1997. Although since 1998 the Treasury Board Secretariat has established a framework of best practices for managing IT projects, many of the problems we cited in past reports have persisted.
- The quality of governance varied widely from project to project. In four of the seven projects we found that governance responsibilities were not carried out adequately because key issues that impacted project performance were either not reported or not resolved.
- Five of the seven projects we looked at were allowed to proceed with a business case that was incomplete or out-of-date or contained information that could not be supported.
- Four of the projects were undertaken by departments that lacked the appropriate skills and experience to manage the projects or the capacity to use the system to improve the way they deliver their programs.
- Depending on the project, the quality of project management ranged from good to seriously flawed. In two cases, poor project management led to long delays and large cost overruns.

The government has responded. The Treasury Board Secretariat, on behalf of the government and the federal organizations we audited, agrees with all of our recommendations. In its responses, the Secretariat describes the actions they will take to address the recommendations.

Introduction

The nature of large information technology projects

3.1 In the last three years, the Treasury Board has approved and the government has undertaken 88 information technology (IT) projects, with costs that totalled $7.1 billion. In addition to these Treasury Board-approved investments, we noted that the government has invested $1.2 billion in the Canada Health Infoway, and the Canada Revenue Agency has invested $431 million in its own information systems. Over the last three years, the government's total investment has been about $8.7 billion.

3.2 IT projects are critical to improving the quality and efficiency of public services. This is commonly known as IT-enabled business change. Nearly all IT projects today have some elements of business change associated with them that go beyond introducing new computer hardware, software, or systems. These elements include introducing new processes, modernizing working practices, and offering new services to the customer. New customer services often involve replacing the manual processing of high-volume routine claims or operations with automated or electronic processing (for example, submitting records of employment online).

3.3 During the last six to nine years, fundamental changes occurred in large IT projects. The federal government has recognized that there are complex IT issues that cross departmental boundaries. That recognition has increasingly resulted in **horizontal initiatives** (for example, Government On-Line and Secure Channel). The efficient use of resources in delivering these types of IT projects depends on integrated decision making across federal organizations. However, when horizontal management is inadequate, the government is less likely to achieve the business transformations that are expected from these projects.

Horizontal initiative—According to the Treasury Board Secretariat, an initiative in which partners from two or more organizations have established a formal funding agreement (for example, a Memorandum to Cabinet, Treasury Board submission, or federal-provincial agreement) to work toward the achievement of shared outcomes.

3.4 Compared with other disciplines, the management of IT projects is relatively new, and organizations are still finding their way with it. Therefore, any organization that invests in IT to support its business must be cautious. Large IT projects are inherently complex, expensive, and risky, and they usually involve long planning and development times.

3.5 Over the last 10 years, other governments and the private sector have studied the challenges facing large IT projects and the reasons why so many have failed. In our 1995 Report, Chapter 12, Systems

under Development, we quoted the Standish Group's 1994 research study. The study noted that "a staggering 31.1 percent of projects will be cancelled before they ever get completed," and "52.7 percent of projects will cost 189 percent of their original estimates." In its 2000 report, the Standish Group noted that a significant trend had emerged in IT projects: most new projects fit within its "Recipe for Success," which limits the size of projects to six months and six people. By 2000, the average cost of a project had fallen to less than half the average cost of a 1994 project.

3.6 In 2004, the Standish survey indicated that the success rate for projects had improved somewhat since 1994. It observed that

> This year's results show that 29 percent of all projects succeeded (delivered on time, on budget, with required features and functions); 53 percent are challenged (late, over budget and/or with less than the required features and functions); and 18 percent have failed (cancelled prior to completion or delivered and never used).

Focus of the audit

3.7 Our audit of the development of large IT projects had three objectives:

- Determine whether the process for approving and managing projects was sufficiently rigorous.
- Determine whether the business cases we examined clearly identified the expected results of the projects and how they would help to meet the business needs of the government and the sponsoring department at a reasonable cost.
- Determine whether the departments and agencies that sponsored the IT projects in our sample are managing large IT projects according to the criteria for governance, business cases, organizational capacity, and project management.

3.8 During this audit, we attempted to determine whether the Treasury Board Secretariat has adequately fulfilled its challenge and oversight responsibilities for the large IT projects in our sample. After consulting the Privy Council Office, the Treasury Board Secretariat has denied us access to most of the information and analysis it collects and prepares, citing Cabinet confidence of a type that cannot be disclosed to us. We met with the Privy Council Office in an attempt to resolve the issue but were unsuccessful. As a result, we are unable to conclude

whether the Treasury Board Secretariat has carried out a proper challenge and oversight role for these projects.

3.9 The Auditor General's reporting obligations are set out in section 7 of the *Auditor General Act*. Among other things, we are required to report to Parliament when we observe that the government has not shown due regard for economy when it makes significant expenditures. Under section 13 of the Act, we have a right to the information and explanations we need to examine these significant expenditures. The extent to which the Treasury Board Secretariat has fulfilled its role in analyzing significant expenditures is an important element of the Auditor General's examination.

3.10 Since we have been denied access to most of the documents we need to complete this examination, we cannot complete this audit and provide Parliament with the assurance that the government has in fact shown due regard for economy in this case. Furthermore, we are required to report to Parliament when we do not receive all of the information and explanations we require. By denying us access to the required information, the government has effectively imposed a limitation on the scope of the Auditor General's examination that may diminish Parliament's fundamental role of holding the government to account. This could be viewed as an infringement of House of Commons privileges. However, only the House itself can determine whether such a breach has occurred.

3.11 The seven sample projects we audited are large IT projects that involve large amounts of money and offer service improvements to large sections of the community. The selected projects were not intended to be a representative sample, but to provide an insight into government management of large IT projects.

3.12 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Reviews of previous recommendations

Previous audit findings persist

3.13 The Office of the Auditor General last examined systems under development in three government-wide audits done in 1995, 1996, and 1997.

3.14 In 1995, we found

- inadequate analysis of underlying business issues,
- inconsistent support from management and project ownership,
- a lack of experienced resources on project teams,
- inconsistent involvement and acceptance on the part of users, and
- a lack of effective monitoring of systems under development.

3.15 In 1996, we examined another set of large IT projects. We reported that our findings reinforced our previous recommendation that strong governance—consistent support and effective sponsorship of IT projects by senior management—is critical to a project's success and the achievement of intended results.

3.16 We noted that government departments often set their projects up for failure by assigning part-time project leaders, with no training or experience in managing large IT projects.

3.17 In its May 1996 report, the Public Accounts Committee directed the government to respond to our 1995 recommendations by

- allocating more resources to monitor large information technology projects;
- submitting an annual report to the Committee on the status of departments' investments in systems that are under development;
- having the Treasury Board Secretariat take steps to ensure that there is complete ownership and accountability for large IT projects; and
- whenever possible, dividing projects into smaller, more manageable components.

3.18 The Treasury Board Secretariat responded to our recommendations and the Committee's report by creating the overall guidance document, Enhanced Management Framework (EMF). In 1998, the Secretariat created An Enhanced Framework for the Management of Information Technology Projects — Part II to help departments apply the EMF.

3.19 Since 1998, the Secretariat has produced little additional guidance on the management of large IT systems. The Chief Information Officer branch of the Treasury Board Secretariat informed us that it is undertaking a complete review of the EMF and has

recently piloted a new methodology for measuring and reporting the outcomes of a few large IT projects.

3.20 Some departments and agencies have had third-party reviews of their projects. We noted that several other governments—notably of the United Kingdom, the United States, and Australia—have adopted new methodologies for monitoring large IT projects. These standard methodologies require independent third parties to assess their largest IT investments at specific intervals during the life of a project. In assessing projects, reviewers apply rigorous oversight that allows them to give advice directly to the executive branch of government.

3.21 For example, in the United Kingdom, the government established the Office of Government Commerce (OGC) to help its departments to develop and deploy successful IT projects. The OGC developed a framework of independent "gateway" reviews, for early detection of any problems that could threaten the success of projects. Since 2001, the OGC's periodic reports have made large IT projects more visible and transparent, making it easier for the government's central agencies to focus on problem areas and, where required, marshal high-level support from management.

3.22 In our previous audits we made recommendations about strengthening governance, business case analyses, project management, and assessments of organizational capacity. The EMF was developed to address these recommendations. Our current audit found that many problems, which our previous reports called attention to, persist because departments and agencies are not following the EMF. We are concerned that although research clearly indicates that small IT projects are more likely to succeed than large ones, departments and agencies are again undertaking large IT projects. Because the portfolio of large-scale departmental IT projects is growing, we believe that a strong governance and management framework is critical if the government is to avoid the past mistakes.

Role of the Treasury Board Secretariat

3.23 We examined IT governance at two levels. Our audit examined how IT governance is exercised at the Treasury Board Secretariat level and at the project level. At both levels, the governance framework includes the administrative structures, the processes, and the people that are involved in various aspects of information technology. If the governance framework is sound with clearly defined roles, responsibilities, and accountabilities, it is more likely that the government will be able to use information technology more successfully.

3.24 More information about project level governance can be found under Governance: Departments and agencies need to improve internal quality reviews (see paragraph 3.45).

3.25 At the Treasury Board Secretariat level, the governance framework is designed to ensure that IT projects fit with the government's priorities, help departments improve their operations or quality of service, offer value for money, and make good business sense for the government. The Treasury Board Secretariat's main role is to review the risks associated with departmental project proposals.

3.26 The Treasury Board's Project Approval Policy states that departments must seek approval before starting certain projects that exceed established departmental project authorities. For projects that involve IT investments, established departmental project authorities range from $1 million (most departments have this level of authority) to $30 million (only National Defence has this level of authority). The minimum project authority for each department is based on the size of the department and its project history. When a department or agency is planning a project that exceeds its established project authority, it must seek the Treasury Board's approval, even if the department or agency plans to use funds that are already in its budget.

3.27 For the types of projects we examined, departments and agencies must seek the Treasury Board ministers' approval for two phases in a project: "preliminary project approval" and "effective project approval." For preliminary project approval, the department or agency presents the complete business proposal, as understood at a preliminary level, with indicative cost estimates. It also seeks the necessary authority to conduct further analyses (and any necessary pilot projects) to add substantive estimates to the proposal.

3.28 Once the preliminary project approval phase is complete and if the original proposal is still sound, the department seeks effective project approval. At this stage, project estimates are considered substantive and the department is expected to manage the project within the time given, using only approved funding and staying within any other limits that Treasury Board ministers impose.

3.29 Treasury Board ministers may set specific conditions, when they approve a proposal, which a department or agency must meet. The Treasury Board may impose conditions related to **on/off ramps**. For projects that involve significant investments in complex IT, the Secretariat may continue to oversee the projects' progress.

On/off ramps—Future decision points are set to determine if the project can continue.

For example, the Secretariat may require regular progress or performance reports, or it may sit on advisory and steering committees that provide governance for the project.

3.30 The Secretariat informed us that before it presents them to the Treasury Board ministers for their consideration, it reviews submissions from departments and agencies to

- ensure that the proposals comply with all applicable policies,
- assess the business value of the proposal, and
- determine whether projects have the essential project management elements to be successful.

3.31 The Secretariat's Chief Information Officer branch, its Procurement and Project Management Policy directorate, and its Financial Systems Acceptance Authority directorate have the specialized knowledge needed to scrutinize proposed IT projects. The Secretariat told us that the program sectors lead the review of the submissions, take advice from other relevant areas in the Secretariat, and combine that advice with their own review when they make recommendations to Treasury Board ministers, for their consideration of the submission.

Denial of access to information

3.32 The Secretariat describes its role as one of selective oversight of departments based on an assessment of risks and the Secretariat's available resources and capacity to oversee and monitor projects.

3.33 We asked to see the analysis that the Secretariat used to support the advice it gave the Treasury Board ministers for five IT projects in our sample. The Secretariat refused us access to most of the documents, citing Cabinet confidence of a type that cannot be disclosed to us (referred to as Cabinet confidence in the rest of the chapter). The Treasury Board Secretariat consulted officials in the Privy Council Office who agreed with its decision, which led the Secretariat to confirm that they would not provide this information.

3.34 We requested the analysis, or evidence of project document review that the Secretariat used to determine whether and how well the project complied with the Enhanced Management Framework and related government policies and guidelines. The analysis we requested related to the business case, options analysis, project charter, project plan, and risk management plan.

3.35 We need this analysis to determine whether the Treasury Board Secretariat has

- given adequate consideration to the governance structure, sound management practices, and specific, achievable deliverables; and
- assessed the organization's readiness to accept the business transformation that the project will require and its capability and commitment to deliver the project successfully.

3.36 Without access to this information, we cannot assess the rigour or quality of the Treasury Board Secretariat's analysis of the projects that we reviewed. In fact, we are unable to audit the Secretariat's important challenge and oversight roles relating to the spending of public funds, particularly funds for the significant IT projects.

Analysis by the Expenditure Management Sector

3.37 Projects that are considered high-risk investments or that require access to reserve funds are subject to special expenditure reviews.

3.38 In 2004, the **Expenditure Management Sector** of the Treasury Board Secretariat designated a group of staff to provide advice on budgetary pressures and on requests for access to funds from the Management Reserve (a source of discretionary funding), and to review and challenge Secretariat expenditure issues and proposals. The designated group's role is to perform a thorough and comprehensive—"due diligence"—review of priority investment proposals to assess whether they will result in a positive return to the Crown. The members of the designated group have government and private sector experience in determining financial implications of decisions.

Expenditure Management Sector—Primarily responsible for managing the reserves assigned to Treasury Board to support priority investments or provide interim funding for urgent program requirements.

3.39 The Expenditure Management Sector did a special expenditure review of the Secure Channel project's proposal for multi-year funding for operations. Its analysis of the information from the project's proponents, and benchmarks and comparative analyses from industry experts, led the designated group to conclude that the Secure Channel project did not have a comprehensive business case. They then concluded that the Secure Channel project did not meet the economic requirements to receive funding from the Management Reserve and that it should receive short term funding while it transitions to a new economic model. Public Works and Government Services Canada (PWGSC), the department responsible for the project, requested funding for one year and approval in principle for funding for an additional four and half years. PWGSC also made a commitment to examine issues raised by the Expenditure Management Sector.

3.40 The recommendations of the Expenditure Management Sector considered the risks and the benefits of the project and were based on a rigorous due diligence review. For example, when it reviewed the business case, the Expenditure Management Sector requested a substantive analysis of measurable results, an options analysis, and an assessment of demand. The Expenditure Management Sector tested the substantive evidence offered by the project's proponents and performed its own assessment of benefits, options, and capacity. These requirements are found in the Treasury Board Project Approval policy and the Enhanced Management Framework (EMF).

3.41 The Expenditure Management Sector analysis only represents a part of the advice provided to Treasury Board ministers. We were unable to determine whether the Secretariat considered the Expenditure Management Sector's advice and recommendations when it examined the PWGSC submission, before presenting it to the Treasury Board for approval, because we were denied access to the analyses performed by the Chief Information Officer branch and other sectors of the Treasury Board Secretariat.

Assessment of seven projects

3.42 We reviewed a sample of seven projects and assessed them against four key criteria that are associated with the successful development of IT projects.

3.43 The sample projects that we audited are large IT projects that involve large sums of money and propose service improvements to large sections of the community (Exhibit 3.1).

3.44 Our observations and recommendations are organized under four key criteria: governance, business case, organizational capacity, and project management. We refer to specific projects to illustrate our findings.

Governance: Departments and agencies need to improve internal quality reviews

3.45 At the project level, governance focuses on delivery of business change at an affordable cost with an acceptable level of risk. Departments and agencies that have demonstrated their readiness to use the government's Enhanced Management Framework (EMF) to govern their large IT projects may require less monitoring by the Treasury Board Secretariat.

Exhibit 3.1 Projects we audited

Project	Department or agency	Description	Budget [1,2]	Spent to date March 2006	Project schedule	Status
Global Case Management System	Citizenship and Immigration Canada (joined by Canada Border Services Agency in 2004)	A multi-year program to replace Citizenship and Immigration Canada's outdated business systems with an integrated system that will improve all of its client operations in Canada and abroad	Initial: $194.8 million Revised: $242.8 million	$197.3 million	2000–07	In development
Secure Channel	Public Works and Government Services Canada and Treasury Board Secretariat	A common, secure infrastructure that ensures Canadians can use the Government On-Line single window to conduct online transactions safely and effectively	Initial: $96 million Revised: $400 million	$400 million	1999 2004	Operational
Expenditure Management and Information System	Treasury Board Secretariat	An integrated financial system designed to support all aspects of government expenditure management	Initial: $16.2 million Revised: $53.7 million	$22.5 million	2000–ongoing	In development
Integrated Revenue Collections	Canada Revenue Agency	A new system to be used to prioritize and allocate collections work according to level of risk	Initial: $2.5 million Revised: $147 million	$30 million	2001–12	In development
2006 Census Online	Statistics Canada	An internet system provided to Canadian households to complete their 2006 census questionnaires online	Initial: $14.5 million Revised: N/A	$12.3 million	2002–06	Operational
AgConnex	Agriculture and Agri-food Canada	A fully integrated system designed to provide a single window for farmers to access the various income support programs offered by Agriculture and Agri-food Canada	Initial: $60 million Revised: $177.4 million	$14 million	2001–03	Discontinued
My Account, My Business Account	Canada Revenue Agency	A series of projects that will provide Canadians and Canadian businesses with a "personalized", secure and private online service for conducting transactions with CRA, provinces and other federal programs	Initial: $22 million Revised: N/A	$11 million	2000–ongoing	Operational

[1] Budget for development costs only—does not include ongoing operations

[2] Revised costs reflect changes in project's scope

3.46 According to the Project Management Policy, the department or agency that sponsors a project (and the required IT investment) is responsible for controlling the costs and risks and for ensuring that the project benefits the organization and meets a business need. It is expected to have the capacity to manage and deliver the project and to demonstrate that it is making a sound investment decision—based on objective, unbiased information. A sound governance framework at the project level is critical to fulfilling these responsibilities.

3.47 Departments and agencies have spending limits for IT projects. Unless the Treasury Board approves extra funding, the spending limits for departments and agencies range from $1 million for most departments to $30 million for National Defence. We outline some representative examples of project governance in the following paragraphs.

3.48 **Integrated Revenue Collections.** The Integrated Revenue Collections (IRC) project is a new system that the Canada Revenue Agency will use to prioritize and allocate collections work according to level of risk.

3.49 The project started in 2001 and progressed very slowly until 2005. For example, the business case that was prepared in July 2001 was not updated until October 2005. The updated business case was approved in September 2006. The governance framework for the project began with quarterly oversight by a bilateral committee of the IT and collections branch staff in 2002 and there was also periodic progress monitoring by the IRC steering committee. By March 2005, the Agency had spent $13 million on this project. We found that it is only since 2005 that the Agency has started to put in place a more rigorous governance framework, a framework that we would have expected to find from the beginning of the project.

3.50 We found that, in 2005, the Revenue Collections branch of the Agency had taken the following measures to improve its governance of the project:

- reorganizing its Technology Solutions directorate,
- establishing a project management office,
- dividing the project into more manageable components,
- clearly defining what needs to be accomplished, and
- assigning clearer responsibilities for carrying out the work.

3.51 Early in 2006, the Canada Revenue Agency took steps to further improve its governance and control of its projects. It established the Resource Investment Management Committee to

- oversee the management and progress of major projects,
- oversee the allocation and control of the Agency's financial resources, and
- establish budget priorities and requirements according to the Corporate Business Plan.

3.52 In addition, the Agency's Finance and Administration branch drafted a project management policy that will give the Agency guidance on managing approved projects effectively, using a clearly established project governance framework.

3.53 All of these measures have brought the governance of the project closer to our expectations.

3.54 **Secure Channel.** The Secure Channel is a complex, innovative, multi-department project that provides Canadians and businesses with secure and private access to online government services. As a key component of the Government On-Line initiative, this common, secure infrastructure ensures that Canadians can use a single window to conduct online transactions safely and effectively, according to federal privacy standards. We did not audit the privacy and security aspects of the Secure Channel.

3.55 During the planning, design, and field trial period (from 1999 to 2003), the Treasury Board Secretariat's Information Management/ Information Technology Management Board (IMB) had final responsibility for oversight, strategic direction, and decision making for the Secure Channel project. The IMB comprised representatives from the technology and program sectors of the larger departments, and it was charged with providing a government-wide strategic direction for all significant IT investments. A key part of its mandate was to ensure that potential Secure Channel users had as much input into its design as possible.

3.56 In December 2003, PWGSC took over the project management responsibility for the Secure Channel project from the Treasury Board Secretariat. The IMB, which the Treasury Board Secretariat chairs, retained the program governance responsibility.

3.57 The governance structure of the Secure Channel has not resolved a number of issues. For example, at the time of our audit, departments and agencies had not agreed on how to sustain this

project or what benefits it will provide. For the Secure Channel to succeed as a strategic government-wide investment, a complete and approved program budget is needed. The budget needs to reflect the full life-cycle costs and financial and non-financial benefits. At the time of our audit, this program budget had not been completed.

3.58 Another unresolved issue is the "take-up" by departments and agencies. Currently, take-up of the Secure Channel is far below projected expectations, and it is not clear whether the future demand for the Secure Channel will increase. For example, in November 2005, the Treasury Board Secretariat asked the major user departments and agencies to confirm their forecasted demand analyses. In January 2006, the Canada Revenue Agency responded and stated that while some of its estimates were reasonable and based on available information, others were "best guesses of take-up rates for applications." Some of the Agency's applications are under development. The Agency advised the Secretariat that it would not necessarily endorse any funding model that the Secretariat or the PWGSC may eventually propose.

3.59 Departments and agencies with major service delivery requirements need to identify and commit to

- key outcomes,
- methods to measure those outcomes and accountability for them,
- an expected delivery schedule, and
- a monitoring process.

3.60 We found that, for four of the seven projects in our sample, the governance framework was deficient. Even though the governance structure was defined for all projects, we found that not all responsibilities were carried out, and not all key business issues were reported and resolved.

3.61 Recommendation. Government departments and agencies should improve their internal quality reviews of IT projects. Senior departmental executives should review the key decision documents that are produced to support the IT project and ensure that the analysis is thorough and supportable before signing off on the submission.

The government's response. The government agrees that improvement is needed in many departments and agencies. The government undertakes many significant business initiatives that are supported by information technology with varying degrees of

complexity. By approaching these IT-enabled projects from a business perspective, rather than simply a technology perspective, departments and agencies will place appropriate attention on planning the project, on managing the necessary transitions, and on involving all key stakeholders.

Business cases: Five of the seven assessed business cases were inadequate

3.62 The business case is the foundation of every sound investment decision. For IT projects, the business case explains the rationale for the project and the project results that are needed to meet an organization's business needs.

3.63 The Treasury Board Secretariat defines a business case as "a detailed investment proposal [that] provides an analysis of all the costs, benefits and risks associated with a proposed investment and offers reasonable alternatives." Treasury Board Secretariat guidelines further note that

> The business case is reviewed and re-validated at each scheduled project review and whenever there is a significant change to the project or the business function. If the business case changes during the course of an IT project, the project needs to be re-approved through the departmental planning and approval process.

3.64 According to the Treasury Board Secretariat guidance on project management, the organization must define what constitutes success in its business case, and must use that definition to measure the project's success later on. A business case would indicate how the project aligns with the organization's broader strategy, and would include

- a definition of the project's scope;
- an options analysis;
- the expected outcomes;
- the cost (in both time and resources);
- a risk analysis; and
- criteria for measuring success.

3.65 Departmental management and ministers need the information from a sound business case to make informed investment decisions. They want to invest in projects that will yield the most benefits for the lowest cost and will take the shortest time to complete. The information that a department or agency presents in its business case must be objective, unbiased, and verifiable.

3.66 The Treasury Board Secretariat is required to evaluate departments' and agencies' compliance with all applicable policies and the benefits of information technology investments that they recorded in their business case analyses.

3.67 Except for the 2006 Census Online project and the My Account, My Business Account project, we found that the business cases for our sample of seven projects were incomplete, were out-of-date, or contained information that could not be supported.

3.68 **Secure Channel.** The Secure Channel project business case contained some information that was either not complete or could not be supported. As a result, this project did not comply with the Treasury Board's policy for approving projects and the guidelines for business cases.

3.69 For example, the business case did not identify a source of funds to sustain the ongoing operating and maintenance costs of the Secure Channel, as required in the Project Approval Policy. On several occasions, project deadlines were extended and short-term funds were advanced, even though the project's business case did not show the expected benefits of the new technology, or how the investment costs would be recovered.

3.70 During the Secure Channel project, the Treasury Board made five requests for a long-term sustainable business model that indicate the source of funds for the operation of the Secure Channel. In the summer of 2005, Public Works and Government Services Canada (PWGSC) prepared a business case, which the Treasury Board Secretariat endorsed. However, we found that the business case did not address the sustainability concerns that we raised in our November 2003 Report. At that time, we recommended that

> The government should address the key risks and challenges it faces by finalizing a comprehensive business case for the Secure Channel project, addressing its long-term financing, establishing mechanisms to encourage the adoption of Secure Channel by departments and agencies, businesses, and Canadian citizens . . . .

3.71 In March 2006, the Treasury Board Secretariat's Expenditure Management Sector summarized its analyses and agreed with our findings that the business case was not comprehensive. By 31 March 2006, the project had received funding 11 times, for a total of $596 million (including $196 million for operations).

3.72 The project began as a "proof of concept," designed to show that the technology could be applied in a government setting. In September 2003, the project received effective project approval to start to use the technology. By May 2004, PWGSC was supposed to

- request the remainder of the funds needed to use the technology;
- clearly identify the source of funds, which could be charged back to departments; and
- produce a business plan that clearly showed how much the system would cost to operate and where the funds would come from, or submit a plan to wind up the project.

3.73 PWGSC did not produce a business plan or a plan to wind up the project. Instead, it provided the Secretariat with the estimated cost of an exit strategy. However, in March 2004, PWGSC received approval to use the funds earmarked for an exit strategy to sustain operations for another six months—including to continue to work on the business plan and to identify a long-term source of funds to sustain Secure Channel operations.

3.74 In April 2005, PWGSC asked the Treasury Board for $126 million to fund operations until 31 March 2006. PWGSC also requested approval in principle for $509 million to fund operations for the next 4.5 years. At that time, PWGSC made a commitment to send an updated request before December 2005, for approval to sign a contract with the Secure Channel service provider and for final approval of the funds. This updated request was actually made in June 2006. When PWGSC made the request in April 2005, it indicated that three departments that use the technology may receive $5.2 billion of indirect benefits—notably, HRSDC and PWGSC could each realize benefits of about $2.5 billion over five years. We asked to see the analysis that supported these projected benefits. However, because we were not given this analysis, we do not know how these amounts were determined.

3.75 The Secure Channel started operations in September 2004. Because PWGSC did not receive firm commitments from departments before the system went into production, it has operated at less than 50 percent of its capacity, for a total cost of $196 million, from its starting date to 31 March 2006.

3.76 The Expenditure Management Information System (EMIS). The Expenditure Management Information System (EMIS) was designed to support all aspects of government expenditure management by providing information on the cost of meeting the government's priorities and achieving particular results. The Treasury

Board Secretariat sponsored the EMIS project and although the project did have a business case, we found that it was incomplete. Without an effective business case, it is difficult to measure whether the EMIS project successfully met its specific objectives and timelines.

3.77 From the beginning, the business goals of the EMIS project were not clear and were not understood by all parties.

3.78 The business case for the project had no comprehensive project plan; the business goals were vague, immeasurable, and not "time limited." As a result, it has been increasingly difficult for the EMIS project team to determine whether they are achieving their overall objectives.

3.79 An options analysis is a key component of any business case, and it is the foundation for deciding what direction the project will take. Because the most recent EMIS business case, in 2004, does not include an options analysis, such as whether to buy a system or build one in-house, we could not determine the reason for the project's direction. Since the project team members had not properly assessed their options, it is not clear if the one they chose—to build the system—was the most appropriate, effective, and efficient. Nevertheless, this project, which is currently valued at $53.7 million, is still proceeding but in a different direction.

3.80 A new business case is being developed for the Treasury Board to consider in the fall of 2006.

3.81 The Global Case Management System (GCMS). In June 2000, Citizenship and Immigration Canada (CIC) presented a business case to the Treasury Board Secretariat for a Global Case Management System (GCMS). CIC proposed that it would develop the new system in-house with external help as needed. The purpose of this project was to replace 14 existing systems with one integrated case-management system that would better meet domestic and international operational needs.

3.82 In March 2001, the project was approved with a total budget of $194.8 million, conditional upon CIC's considering an off-the-shelf package instead of developing a system in-house.

3.83 The overall objective of the project was to develop an integrated case management system. However, the business case did not define measurable objectives and benefits. CIC had to consider purchasing an off-the-shelf system, which involved modifying its business case to focus on different business needs and new technologies. With the modified business case, CIC obtained effective project approval in January 2002.

3.84 CIC had to struggle with a number of problems, including changes in the project's scope, difficulties accessing funds, and a lack of people with the required skills. In 2003 and 2005, CIC approached the Treasury Board to request budget increases and more time.

3.85 We found that CIC received budget increases without submitting a revised business case to the Treasury Board. CIC included specific issues in its requests. However, the original business case was not revisited to provide a clearer picture of the project or to redefine the objectives and outcomes as the project evolved. The cost of the GCMS project is now estimated to be $242.8 million—the original estimate was $194.8 million—and the system is scheduled to be completed by August 2007.

3.86 **My Account and 2006 Census Online.** My Account and 2006 Census Online had sound business cases. The 2006 Census Online project gave Canadians the option of completing their 2006 census questionnaires electronically and using the internet to submit them to Statistics Canada securely and confidentially. My Account is a series of projects that will give Canadians and Canadian businesses a personalized, secure, and private online service for conducting transactions with the Canada Revenue Agency, the provinces, and federal programs.

3.87 We found that these two projects, with sound business cases (either as originally submitted or after revisions) proved feasible, met a defined business need, and made sense from a value-for-money perspective.

3.88 **AgConnex.** AgConnex was originally designed to give farmers a single window to access the various income support programs offered by Agriculture and Agri-food Canada. However, in the summer of 2002, the launch of the joint federal/provincial Agriculture Policy Framework significantly changed the scope and cost of the project, which was originally estimated at $60 million. By the summer of 2003, the estimated cost of the project had increased to over $177 million. In 2003, the Department prepared a revised business case after it had spent about $14 million. Six months later, the Department decided not to invest further in this project and it was discontinued because it was considered high risk. The Department followed up by conducting a business alignment exercise, at an additional cost of $8.5 million, which resulted in several smaller, lower risk projects. We did not audit these projects.

3.89 Recommendation. Before seeking effective project approval, departments and agencies should prepare a business case that includes, at a minimum, precise and measurable objectives; a full analysis of options, benefits, costs, and risks; and an implementation plan.

The government's response. The government agrees and will continue to improve the calibre and breadth of departmental business cases.

3.90 Recommendation. The Treasury Board Secretariat should improve the requirements for sound business cases prepared by departments and agencies to ensure that they include, at a minimum, precise and measurable objectives; a full analysis of options, benefits, costs, and risks; and an implementation plan.

The government's response. The government agrees. The Treasury Board Secretariat has undertaken a comprehensive policy suite renewal that includes the project management policy. In this context, the Secretariat has been working with departments and agencies to address several matters related to the management of projects, including governance; risk management controls; capacity; and integration with investment planning and procurement management.

As part of this policy suite renewal, the Secretariat has been working with departments and agencies on improving the Enhanced Management Framework (which provides the supporting project management methods, processes, guidelines and tools for IT-enabled business projects) and looking at ways to share best practices. For example, significant progress has been made in the integration of outcomes management into the management of IT-enabled business projects. When fully implemented, this will enable departments and agencies to provide greater clarity around the business problem that is to be addressed, to continuously align project activities to the desired outcomes, to monitor outcomes even after the project is concluded, and to measure results. The Secretariat has completed a number of pilot projects related to outcomes management and is working towards ensuring greater understanding and use by departments.

Organizational capacity: Organizational capacity was assessed for only two of the seven sample projects

3.91 In this chapter, organizational capacity refers to the technical and managerial ability to deliver an IT project. It also refers to the ability of the entire organization to improve the way it does business by using all of a system's capabilities.

3.92 According to the Treasury Board's Project Management Policy and the Project Risk Assessment and Management Guidelines, departments and agencies need to objectively assess and manage the risks associated with their project. In our view, this includes their ability to use the system to improve the way they deliver their programs. We found that only two of our seven sample projects—2006 Census Online and My Account, My Business Account—were rigorously assessed in their Project Profile and Risk Assessment, as required by the Project Management Policy. We found that organizations proceeded with projects without having appropriate expertise to manage them.

3.93 Expenditure Management Information System (EMIS). The Treasury Board Secretariat sponsored the EMIS project, and we found it lacked the organizational capacity for the new system. The Secretariat never assessed whether it had enough people with the appropriate skills and experience to complete the project. Specifically, the Secretariat never determined the resources it needed to meet the objectives of the EMIS project. In addition, we found no evidence of a formal mechanism to align human resources planning with technology planning. In November 2005, the Treasury Board Secretariat reported that 33 percent of its funded positions associated with the EMIS project were vacant.

3.94 High turnover in management positions has also been a major problem. Since 2001, the EMIS project has had six project managers and seven senior responsible officers.

3.95 Clearly, poor organizational capacity—not filling vacant positions with experienced and qualified people—prevented the Secretariat from achieving its goals. The Secretariat has recently made significant improvements to strengthen its governance and project management practices. However, at the time of our audit, there were not enough experienced and qualified people working on the project for it to progress as originally planned.

3.96 2006 Census Online. Statistics Canada thoroughly and successfully assessed the Census 2006 Online project and built its capacity, and that of its partners, to complete the project.

3.97 Business and IT project leaders had been managing similar Statistics Canada projects for several years. The knowledge and experience of the staff was preserved during the project because there was little turnover on the project team. Their experience allowed them

to prepare contingency plans for problems that could have caused Statistics Canada to miss a non-negotiable deadline: Census Day.

3.98 Recommendation. At the start of a project, departments and agencies should clearly demonstrate that their organization is ready to accept the business transformation that comes with the project and has the capability and commitment to successfully deliver the project. Specifically, departments and agencies should analyze their track record in

- completing projects of similar size and complexity;
- completing skills appraisals and plans to address shortfalls;
- planning for business preparation, transition, and operational phases; and
- considering key stakeholder buy-in and commitment.

The government's response. The government agrees and will continue to work with departments in this area. The government recognizes the need for a collaborative environment where project management practitioners and executives from across government can contribute to improving the understanding and application of mature project management disciplines. The Treasury Board Secretariat will continue to work with departments and agencies to ensure that a sound community of practice is established.

3.99 Recommendation. Before recommending that the Treasury Board approve an IT project, the Treasury Board Secretariat should

- ensure that the departments and agencies submit their analyses of organizational capacity, and
- validate the content and approach of these assessments.

The government's response. The government agrees but this is a joint responsibility of the Treasury Board Secretariat and departments and agencies. The Secretariat has been actively engaged in the development of a standardized capacity assessment tool that is based on industry standards to make it easier for departments and agencies to assess their organizational capacity and for the government to validate those assessments. Where appropriate, Secretariat officials will request completed assessments from departments and conduct high-level reviews to understand the approach used by departments and to assess high-level completeness. Departmental and agency executives remain responsible for conducting the detailed analyses and creating the appropriate action

plans to ensure that their organizations have the necessary skills and environment to successfully deliver their business projects.

Project management: Four projects were well managed

3.100 An organization uses project management to control and coordinate its activities, resources, time, and costs.

3.101 The objective of developing sound project management is to ensure that the project produces successful outcomes, within a specified time. A key component of project management is risk management, which involves assessing the potential impact of risks, continuously monitoring the risks, and dealing with potential risks before they arise. Risks must be identified and controlled for all IT projects if the projects are to succeed.

3.102 In this audit, we looked for evidence that projects had employed good project management practices and that they could anticipate and control risk. We found that the quality of project management varied widely from project to project—from good to seriously flawed. Projects that had weak project management practices have experienced long delays and large cost overruns.

3.103 **The 2006 Census Online.** By having sound project management and an effective governance framework, Statistics Canada showed good project management for the 2006 Census Online project, which met its requirements on time and within budget. It had specific project "gates" (decision points) and deliverables. The organization continuously reported on progress and addressed key issues, such as managing risks, managing changes as they arose, and financial reporting.

3.104 The 2006 Census Online project clearly defined roles and responsibilities for meeting its objectives. The management structure allowed close collaboration among partners and was effective for this large, complex, and multidisciplinary initiative that had a fixed delivery date and budget.

3.105 Using a thorough risk management strategy, the 2006 Census Online project was able to assess and deal with the various challenges and risks that might have prevented it from achieving the project's objectives.

3.106 **Expenditure Management Information System (EMIS).** The EMIS project, which began in 2000, is an example of ineffective project management. Before January 2006, the EMIS project had no

effective project plan—critical to ensure that it would be able to meet its goals. It did not have a performance measurement framework with clear reporting timelines, nor did it have a detailed project plan with specific project milestones and deliverables.

3.107 We found that risk management for the project was weak and incomplete. Although a risk management plan was developed in March 2004, it was not used effectively. The plan identified risks and their severity, but we did not see evidence that those risks were mitigated.

3.108 Since January 2006, the EMIS project team has made significant changes to strengthen the project's practices for managing risks and managing the project as a whole.

3.109 We acknowledge that sound project management does not necessarily mean that a project will be delivered within budget and on time. However, good project management is essential to delivering a system that works.

3.110 Four projects that we audited—the 2006 Census Online, Global Case Management, My Account, and Secure Channel—were well managed.

3.111 Recommendation. Departments and agencies should

- comply with the Treasury Board Secretariat project management guidance,
- closely manage the project risks,
- monitor key success factors, and
- regularly report to management any significant internal or external event that may prevent the expected project benefits or result in cost overruns or in the project not being delivered on time.

The government's response. The government agrees. It is clear that departments are accountable for bringing forward well thought out proposals that are supported by sound business cases and achieved through well-managed projects. A number of departments are using third-party reviews to monitor their IT-enabled business projects. The Treasury Board Secretariat will undertake additional work to establish a more consistent approach to employing these reviews as part of the ongoing oversight of such projects across the Government of Canada. The government is committed to clarifying the policy instruments relating to project management and to creating the supporting

environment required for success, including an indicator in the Management Accountability Framework to assess how well departments are managing their projects.

3.112 Exhibit 3.2 summarizes our criteria, the projects we reviewed, and how well each project rated against the criteria.

Exhibit 3.2 Sample projects assessed against key criteria

Audit criteria	Global Case Management System	Secure Channel Project	Expenditure Management and Information System	Integrated Revenue Collections	2006 Census Online	AgConnex	My Account, My Business Account
Governance Clear governance structure that shows accountability relationships and is designed to ensure that the project is completed successfully	◓	○	○	◓	●	●	●
Business Case Evidence that projects are aligned with and support departmental and government business directions and priorities	◓	○	○	◓	●	◓	●
Organizational Capacity Project management teams that are experienced and have the leadership, capabilities, and commitment to deliver their projects	○	◓	○	N/A	●	◓	●
Project Management The department or agency's ability to handle changes to planned deliverables; manage changes in scope; identify and resolve issues, during the project; and identify, report, and manage project risks	●	●	○	◓	●	N/A	●

● The criterion was met over the life of the project.

◓ The criterion was partially met over the life of the project.

○ The criterion was not met over the life of the project.

N/A Not assessed

Conclusion

3.113 Overall, the government has made limited progress since our last audit of IT projects in 1997. Although, in 1998, the Treasury Board Secretariat established a framework of best practices for managing IT projects, many of the problems we cited in past reports have persisted.

3.114 With the exception of the 2006 Census Online project and the My Account, My Business Account project, we found that the proponents of large IT projects had not adequately explained the project's rationale or the results they expected to achieve in their business cases. In addition, they had not adequately assessed their capacity to take on high-risk IT projects that have long life spans and require large amounts of public funds to build and maintain.

3.115 Most projects we looked at suffered from the same shortage of experienced and qualified people and inadequate analysis of key business issues as before. The lack of progress is worrisome, because large IT projects are becoming more and more complex and often involve a growing number of players across government.

3.116 Although we found that four of the seven projects were well managed, the quality of project management varied widely. Those with weak project management practices experienced long delays and large cost overruns.

3.117 One of the objectives of this audit was to determine whether the Treasury Board Secretariat has adequately fulfilled its challenge and oversight responsibilities as part of its role in the governance of large IT projects. Since we were denied access to most of the evidence of the Secretariat's review of project documents such as the business case, options analysis, project plan, and risk management plan for our sample of IT projects, we are unable to determine whether it followed a complete and rigorous process when it reviewed these IT projects.

About the Audit

Objectives

In considering the development of large IT projects, we had three objectives.

We wanted to determine

- whether the process for reviewing and approving projects was sufficiently rigorous;
- whether the business cases and the project charters for the projects that we examined had clearly identified the expected results, and how they would contribute to meeting the business needs of the government and the sponsoring department; and
- whether the projects were managed effectively.

Scope and approach

Our audit focused on two levels:

- **Treasury Board Secretariat level.** The Treasury Board Secretariat's review and oversight of large projects, more specifically, large IT projects.
- **Project level.** Seven large IT projects in the following departments: Public Works and Government Services Canada, Citizenship and Immigration Canada, Statistics Canada, the Canada Revenue Agency, Agriculture and Agri-Food Canada, and the Treasury Board Secretariat.

We assessed the process that departments and agencies use to approve and manage projects, the soundness of their business cases, and their organizational capacity to carry them out.

We could not audit the review and oversight role played by the Treasury Board Secretariat because it has denied us access to most of the information and analysis it collects and prepares, citing Cabinet confidence. The government has effectively imposed a limitation on the scope of the Auditor General's examination.

Criteria

Our audit assessed the performance of the Treasury Board Secretariat. It also examined how well the departments and agencies that sponsor the seven IT projects in our sample meet the following criteria:

- **Governance.** Clear accountabilities and a governance structure have been established to ensure that projects are completed successfully.
- **Business case.** Large IT projects are aligned with and support departmental and government business directions and priorities.
- **Organizational capacity.** Project management teams are skilled and experienced and have the leadership, capabilities, and commitment to deliver their projects successfully.

- **Project management.** IT project management is appropriate and based on risk management. It can be used to deal with changes to planned deliverables and the project scope; to identify and resolve project issues that arise during the project life cycle; and to identify, report, and manage project risks.

Audit work completed

Audit work for this chapter was substantially completed on 30 June 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 3. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Government's response
Assessment of seven projects	
3.61 Government departments and agencies should improve their internal quality reviews of IT projects. Senior departmental executives should review the key decision documents that are produced to support the IT project and ensure that the analysis is thorough and supportable before signing off on the submission. **(3.45–3.60)**	The government agrees that improvement is needed in many departments and agencies. The government undertakes many significant business initiatives that are supported by information technology with varying degrees of complexity. By approaching these IT-enabled projects from a business perspective, rather than simply a technology perspective, departments and agencies will place appropriate attention on planning the project, on managing the necessary transitions, and on involving all key stakeholders.
3.89 Before seeking effective project approval, departments and agencies should prepare a business case that includes, at a minimum, precise and measurable objectives; a full analysis of options, benefits, costs, and risks; and an implementation plan. **(3.62–3.88)**	The government agrees and will continue to improve the calibre and breadth of departmental business cases.

Recommendation	Government's response
3.90 The Treasury Board Secretariat should improve the requirements for sound business cases prepared by departments and agencies to ensure that they include, at a minimum, precise and measurable objectives; a full analysis of options, benefits, costs, and risks; and an implementation plan. (3.62–3.88)	The government agrees. The Treasury Board Secretariat has undertaken a comprehensive policy suite renewal that includes the project management policy. In this context, the Secretariat has been working with departments and agencies to address several matters related to the management of projects, including governance; risk management controls; capacity; and integration with investment planning and procurement management. As part of this policy suite renewal, the Secretariat has been working with departments and agencies on improving the Enhanced Management Framework (which provides the supporting project management methods, processes, guidelines and tools for IT-enabled business projects) and looking at ways to share best practices. For example, significant progress has been made in the integration of outcomes management into the management of IT-enabled business projects. When fully implemented, this will enable departments and agencies to provide greater clarity around the business problem that is to be addressed, to continuously align project activities to the desired outcomes, to monitor outcomes even after the project is concluded, and to measure results. The Secretariat has completed a number of pilot projects related to outcomes management and is working towards ensuring greater understanding and use by departments.

Recommendation	Government's response
3.98 At the start of a project, departments and agencies should clearly demonstrate that their organization is ready to accept the business transformation that comes with the project and has the capability and commitment to successfully deliver the project. Specifically, departments and agencies should analyze their track record in • completing projects of similar size and complexity; • completing skills appraisals and plans to address shortfalls; • planning for business preparation, transition, and operational phases; and • considering key stakeholder buy-in and commitment. (3.91–3.97)	The government agrees and will continue to work with departments in this area. The government recognizes the need for a collaborative environment where project management practitioners and executives from across government can contribute to improving the understanding and application of mature project management disciplines. The Treasury Board Secretariat will continue to work with departments and agencies to ensure that a sound community of practice is established.
3.99 Before recommending that the Treasury Board approve an IT project, the Treasury Board Secretariat should • ensure that the departments and agencies submit their analyses of organizational capacity, and • validate the content and approach of these assessments. (3.91–3.97)	The government agrees but this is a joint responsibility of the Treasury Board Secretariat and departments and agencies. The Secretariat has been actively engaged in the development of a standardized capacity assessment tool that is based on industry standards to make it easier for departments and agencies to assess their organizational capacity and for the government to validate those assessments. Where appropriate, Secretariat officials will request completed assessments from departments and conduct high-level reviews to understand the approach used by departments and to assess high-level completeness. Departmental and agency executives remain responsible for conducting the detailed analyses and creating the appropriate action plans to ensure that their organizations have the necessary skills and environment to successfully deliver their business projects.

Recommendation	Government's response
3.111 Departments and agencies should • comply with the Treasury Board Secretariat project management guidance, • closely manage the project risks, • monitor key success factors, and • regularly report to management any significant internal or external event that may prevent the expected project benefits or result in cost overruns or in the project not being delivered on time. (3.100–3.110)	The government agrees. It is clear that departments are accountable for bringing forward well thought out proposals that are supported by sound business cases and achieved through well-managed projects. A number of departments are using third-party reviews to monitor their IT-enabled business projects. The Treasury Board Secretariat will undertake additional work to establish a more consistent approach to employing these reviews as part of the ongoing oversight of such projects across the Government of Canada. The government is committed to clarifying the policy instruments relating to project management and to creating the supporting environment required for success, including an indicator in the Management Accountability Framework to assess how well departments are managing their projects.

Report of the Auditor General of Canada to the House of Commons—November 2006

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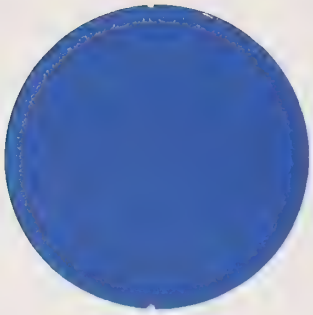


Report of the Auditor General of Canada to the House of Commons

NOVEMBER

Chapter 4
Proper Conduct of Public Business—
Public Safety and Emergency Preparedness Agencies

Office of the Auditor General of Canada



2006



Report of the

Auditor General of Canada

to the House of Commons

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Chapter 4

Proper Conduct of Public Business—
Public Safety and Emergency Preparedness Agencies

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.

The Report is available on our website at www.oag-bvg.gc.ca.

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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-4E
ISBN 0-662-44368-3



Chapter

4

Proper Conduct of Public Business

Public Safety and Emergency Preparedness Agencies

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Proper Conduct of Public Business
Public Safety and Emergency Preparedness Agencies

Main Points

What we examined

When public business is conducted properly, public servants comply with laws and policies and use public funds and other assets entrusted to them to benefit the public and not themselves.

We examined key aspects of the proper conduct of public business in three agencies: the Royal Canadian Mounted Police (RCMP), Correctional Service Canada, and the Canada Border Services Agency. We looked at whether each agency has values and ethics programs that promote good behaviour and has internal disclosure (or "whistle-blowing") policies that support the reporting of wrongdoing. We also examined the role that internal audit plays in verifying compliance with laws, policies, and regulations.

We looked at three areas where we believe a risk of abuse is present—contracting, use of acquisition (credit) cards, and use of overtime and leave.

We did not look at issues such as the use of excessive force, harassment, or security breaches.

Why it's important

Misuse and abuse of public resources has become a major concern to Parliament and to Canadians in general. Over the last five years, the federal government has made a major investment in values and ethics programs, has introduced whistle-blower legislation in Parliament, and has begun strengthening internal audit in departments and agencies.

The three public safety agencies we audited employ a total of about 40,000 public servants and spend a total of about $5.6 billion each year, making them a significant factor in the conduct of the federal government overall.

What we found

- Although the two-year-old Canada Border Services Agency is still developing its programs, all three agencies generally have in place programs of values and ethics, internal disclosure, and internal audit. However, only about 20 percent of employees report having received training in values and ethics. Our survey of 400 non-management

employees in the three agencies showed that no more than half are familiar with agency values and ethics programs.

- Our analysis found that having programs in place is not enough alone to encourage employees to report wrongdoing by colleagues. They also need to know that management will follow up on their reports and will preserve their confidentiality, and that their peers will continue to respect them. While 70 to 80 percent of employees said they themselves would report misconduct, they had significant doubts about their co-workers' willingness to do so. The extent to which management was perceived to take reports of wrongdoing seriously and investigate them ranged from 60 percent at the RCMP to a low of 45 percent at the Border Services Agency.
- We found few cases of abuse of leave in order to generate excessive overtime.
- We found that all three agencies had improperly sole-sourced contracts, to the detriment of fairness and equal access—two principles that government agencies are required to apply in the proper conduct of their contracting activities. The Canada Border Services Agency and Correctional Service Canada did not have adequate quality assurance practices in place for contracting activities.
- We found outright abuse of acquisition cards in only a small number of cases. Nevertheless, the RCMP and the Canada Border Services Agency had high levels of non-compliance with the rules. We also found that purchase limits had been exceeded, and purchases were sometimes split into two bills to evade controls. There was poor control at all three agencies, with individuals allowed to verify their own purchases and documentation frequently lacking. The Treasury Board's policy explicitly forbids the use of acquisition cards for vehicle operations and maintenance, but the Treasury Board Secretariat has allowed it in practice. This has led to a "grey area" in how agencies view the rules and has reduced value for money in some cases.

The agencies have responded. The agencies generally agreed with our findings and most recommendations.

Introduction

What is the "proper conduct of public business"?

4.1 "Proper conduct of public business" means that management and other federal public servants not only comply with laws and policies in the course of their work but, in particular, use public funds and other assets to benefit only the public and not themselves. Lapses in proper conduct can therefore range from criminal acts to merely poor business judgment, such as extravagant and unnecessary business travel.

4.2 Proper conduct encompasses both compliance with law and regulations and an absence of abuse. "Abuse" has been defined by the US Government Accountability Office as ". . . distinct from fraud, illegal acts, and violations of provisions of a contract or grant agreements." Instead, abuse involves deficient or improper behaviour that a prudent person would not consider reasonable and necessary business practice. The *Values and Ethics Code for the Public Service* says that "Public servants shall act at all times in a manner that will bear the closest public scrutiny, an obligation that is not fully discharged by simply acting within the law."

Ensuring the proper conduct of public business

4.3 Departments and agencies can take several formal measures to ensure proper conduct:

- **Supportive programs.** The capstone of Treasury Board's Management Accountability Framework is *Public Service Values*, which states that "departmental leaders [should] continually reinforce the importance of public service values and ethics in the delivery of results to Canadians." Most departments and agencies have responded with values and ethics programs designed to increase awareness about ethical challenges and appropriate responses to them. Beginning January 2006, Treasury Board policy makes such training compulsory for all new public servants.
- **Controls on high-risk assets and activities.** Certain government assets and activities are vulnerable to risk of abuse by employees. Experience has shown that contracting, for example, can lend itself to favouritism and even kick backs; "acquisition" (or government credit) cards might be used to purchase unauthorized goods and services. Abuse can occur in human resource activities such as appointments, promotions, leave use, and overtime pay. Because these activities are at risk, departments and agencies

usually put controls in place to ensure that resources are used only for approved purposes.

- **Internal disclosure**. The Treasury Board Secretariat has issued an internal disclosure policy aimed at allowing public servants to report incidents of wrongdoing in the workplace to a senior departmental officer. In addition, the government established the Public Service Integrity Office in 2001 to provide a point of contact for public servants who have concerns about wrongdoing that they believe their departments have not addressed adequately. Parliament recently strengthened disclosure provisions with new whistleblower legislation. This Act, however, was not in effect during the period we audited.

- **Internal audit units**. The internal audit units located within each federal department or organization need to be alert to indications of fraud and abuse and also need to periodically conduct compliance audits of high-risk areas to ensure that controls are operating as intended. Having an effective internal audit function within a federal organization can also act as a deterrent by increasing the likelihood that improper acts will be discovered.

- **Sanctions.** Employees who have behaved improperly can suffer appropriate sanctions. Departments have formal disciplinary mechanisms to apply sanctions when required.

4.4 These formal mechanisms are important, but formal programs go only so far. Like all communities, government agencies have networks of informal communication, personal relationships, and community norms that collectively form a "culture." An important aspect of leadership at all levels is to demonstrate proper conduct and to be a positive influence on agency culture.

Focus of the audit

4.5 This audit focused on the RCMP, the Canada Border Services Agency, and Correctional Service Canada, which, together, employ most of the employees in the Public Safety and Emergency Preparedness portfolio.

4.6 We assessed the adequacy of programs to support positive behaviour by employees, and we surveyed 400 employees at the three agencies to determine whether the programs had reached them and were working as intended. In particular, we reviewed values and ethics initiatives, internal disclosure programs, and internal audit. We

looked at whether programs complied with government policies. We did not assess the use of sanctions.

4.7 We also examined selected high-risk areas (acquisition cards, overtime use, and contracting) to determine whether controls were adequate.

4.8 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Programs to support proper conduct

4.9 The Treasury Board of Canada Secretariat in its *Modern Comptrollership Practices: Toward Management Excellence* calls on agency heads and senior managers to establish programs that can help employees deal appropriately with ethical challenges. Deputy heads are to "encourage and maintain dialogue" on values and ethics. The *Values and Ethics Code for the Public Service* says

- public servants shall endeavour to ensure the proper, effective, and efficient use of public money;
- in the public service, the means used to achieve the ends should be as important as the achievements themselves; and
- public servants shall act at all times in a manner that will bear the closest public scrutiny—an obligation that is not fully met by simply acting within the law.

4.10 Government policies require that agencies have structures in place to implement the Code. This includes designating a senior official responsible for assisting public servants to resolve issues arising from the application of the Code. A second senior officer must be appointed to implement the policy of internal disclosure of wrongdoing. The Office of Values and Ethics in the Public Service Human Resource Management Agency of Canada reports results annually.

4.11 We examined the values and ethics programs of each agency to determine whether it had supportive programs in place. We expected that the agencies would have training programs that would deal with specific ethical issues facing their staff and that the agencies would be aware of how effective their efforts to support ethical behaviour were.

Values and ethics programs have not yet reached the majority of employees

4.12 We found that all three agencies had most of the required structures in place.

- Agency heads have actively encouraged and promoted dialogue on values and ethics issues, and these issues are discussed at the senior executive meetings.
- All three have identified a senior official as their ethics champion.
- The RCMP and the Canada Border Services Agency have designated specific staff members to implement their ethics programs. Both agencies maintain websites that offer assistance to employees. Correctional Service Canada has delegated the implementation of the program to the performance assurance sector. Correctional Service has developed reference materials for staff and also maintains a website with typical ethical dilemmas for staff to review.
- All three agencies have reported to the Treasury Board on their values and ethics programs—the RCMP through a personal briefing from the RCMP Commissioner to the Secretary of the Treasury Board, in addition to its written reports.
- The RCMP has made significant efforts to direct its ethics training to specific institutional problems. Correctional Service Canada is also working to identify where ethical breakdowns occur, focusing on the relationship between its officers and offenders. The Border Services Agency has established a working group to examine the issue of officers being vulnerable to criminal coercion. Border Services has an established Internal Affairs section that conducts investigations of employee misconduct or malfeasance. Senior management has implemented an action plan to promote awareness and to address gaps in values and ethics.

4.13 Agencies are making efforts to provide values and ethics training to members. For example, the RCMP provides ethics awareness training to 1,200 cadets each year. In 2004–05 the RCMP also provided ethics awareness presentations to about 1,100 other members at various rank levels. Since 2002 Correctional Service Canada has trained about 1,200 individuals throughout the organization. Based on our survey of employees (see paragraph 4.15), only about 20 percent of agency employees can recall ever attending any formal values and ethics training.

4.14 All three agencies maintain documentation on disciplinary actions and grievances that involve abuse of resources. Except for that step, they have not evaluated the effectiveness of their values and ethics programs.

4.15 We conducted a survey, between June and October 2005, of over 400 non-management employees in the three agencies to determine the extent to which they were aware of their particular agency's values and ethics program. The results have indicated that these programs have not yet reached a majority of employees (Exhibit 4.1):

- No more than half of the employees at any of the three agencies said that they are familiar with the values and ethics program in their specific organization.
- No more than half of the employees believe that senior management works toward making values and ethics an important part of their organization's culture. At both the Canada Border Services Agency and Correctional Service Canada, more staff disagreed with this statement than agreed with it.
- Approximately half of the employees at the RCMP and Correctional Service Canada identified their respective commissioner as the source of messages regarding values and ethics. About one third of employees surveyed at the Canada Border Services Agency said that their president originated messages about values and ethics.

4.16 These results indicate that employees of the public safety agencies are just beginning to be aware of their particular values and ethics programs. Moreover, many employees do not believe that senior management think the program is important.

Lack of confidence in management and peers decreases willingness to come forward

4.17 Treasury Board policy requires that departments have mechanisms and ethics staff in place to allow employees to bring forward information concerning wrongdoing in the workplace. Departments are supposed to appoint a senior official to receive and investigate complaints of wrongdoing in a timely manner. Employees are to be informed of the process in their department. In addition, the government has established an alternative system through the creation of the Public Service Integrity Office for cases that staff believe cannot be discussed in their own department.

Exhibit 4.1 Senior management has yet to reach employees about the program



Note: See **About the Audit** at the end of this chapter for an explanation of how survey results are calculated and reported.

4.18 The RCMP are not covered by the general policy as there are separate provisions in the *Royal Canadian Mounted Police Act*. Members of the RCMP are under a code of conduct that covers a wide range of professional behaviour. Members have a duty to promptly report any violations of the code of conduct that they are aware of. The RCMP have decided to voluntarily adhere to the public service policy on internal disclosure, including use of the position of the Public Service

Integrity Office for cases where members believe they cannot use the RCMP's own system for reporting wrongdoing. The RCMP also provides a toll-free phone line, an email address, and direct access to ethics staff for employees who wish to come forward with reports of wrongdoing.

4.19 Both Correctional Service Canada and the Canada Border Services Agency have implemented the internal disclosure policy. At Correctional Service, the performance assurance sector is responsible. Like the RCMP, Correctional Service Canada provides a toll-free phone line to report wrongdoing. At Border Services, employees report any wrongdoing to the internal audit unit. However, internal affairs may carry out any investigations.

4.20 Our employee survey of the three organizations gave us considerable information about how much employees know about internal disclosure programs. Few employees appear to be aware of the program—awareness ranged from less than 27 percent at Border Services to under 40 percent at the RCMP. However, more people said they knew how to report misconduct—from about 30 percent at Border Services to over 60 percent at the RCMP.

4.21 There was no real difference among the three agencies in the employees' willingness to report misconduct—70 to 80 percent said they would do so if they became aware of wrongdoing. However, they were much less optimistic about whether their colleagues would be willing to report a wrongdoing; they estimated that only about 40 per cent would be willing to report.

4.22 A high number of employees disagreed with the statement that people who report misconduct in the workplace are generally respected. At least 26 percent of the RCMP staff disagreed with this statement, over 34 percent of Border Services Agency employees disagreed, and over 40 percent of the Correctional Service staff disagreed with it.

4.23 While the majority of RCMP members (about 60 percent) believe their organization will take reports of misconduct seriously and investigate them, it was different at the other public safety agencies. About 50 percent of employees surveyed at the Correctional Service and fewer than 45 percent of Border Services employees said that they believed their specific organizations would take reports of misconduct seriously and investigate them. There was also a lack of confidence that disclosures of wrongdoing would be kept confidential. There was a sharp difference in the number of public servants who believed that

senior management is committed to encouraging employees to bring forward knowledge of misconduct. A majority at the RCMP (about 56 percent) believed in management's commitment, and approximately one third of employees at the Correctional Service and Border Services thought senior management was behind the program (Exhibit 4.2).

Exhibit 4.2 Employee confidence in support from management and peers is low



Note: See **About the Audit** at the end of this chapter for an explanation of how survey results are calculated and reported.

4.24 Our analysis of the survey results found that programs enabling and encouraging internal disclosure do not, in themselves, increase employees' willingness to report wrongdoing. Such programs may be necessary, but they are not sufficient. From the employees' point of view, such activities might appear to be only "window dressing" if they believe that their bosses and their co-workers will not support them. Based on our analysis, employees' self-reported willingness to disclose misconduct is influenced by

- the degree to which reporting misconduct is respected by their co-workers,
- the degree to which senior management will take it seriously and investigate it,
- the degree to which senior management will protect the confidentiality of the person making the disclosure, and
- senior management's commitment to encouraging employees to disclose misconduct.

4.25 Overall, the survey results indicate the following:

- employees' knowledge about the programs is poor at all three agencies; and
- employees' confidence in management support, in peer support, and in confidentiality for the person reporting the wrongdoing ranged from moderate at the RCMP to low at Correctional Service Canada and the Canada Border Services Agency.

Internal audit provides adequate information

4.26 Internal audit is another support for proper conduct as it tests the integrity of management controls. This process provides assurance that assets are protected and that there is compliance with the regulations. The knowledge that transactions might be audited also acts as a deterrent to wrongdoing by increasing the risk of discovery. Because internal audit has a broad mandate with numerous processes to be covered, we did not expect it to devote a large number of resources to the areas that may be subject to employee abuse. We expected that audit resources would be allocated on the basis of risk and that abuse would be factored into those risks.

4.27 We found that all three agencies have done this. They all have risk-based plans. All three have undertaken audits in the same areas that we identified as high risk: overtime and leave, acquisition cards,

and contracting, as well as additional areas. We concluded that internal audit is playing its expected role in supporting compliance.

Compliance in high-risk activities

4.28 Employees are entrusted to manage and use significant public resources while doing their jobs. There is always a possibility that resources can be diverted to benefit employees rather than the public. We therefore looked at three areas that we consider to be subject to a relatively high risk of abuse:

- employee manipulation of leave to generate excessive overtime earnings,
- use of acquisition (credit) cards, and
- contracting.

Leave abuse is a relatively insignificant cause of overtime

4.29 Correctional Service Canada and the Canada Border Services Agency operate 24 hours a day, seven days a week. In addition, employees are subject to unpredictable spikes in workload and job stress caused by factors like incidents at prisons and seizures of contraband goods. Managing overtime is therefore a complex task. We did not include the Royal Canadian Mounted Police (RCMP) in this section of our audit.

4.30 It is possible for employees to collude to use their leave entitlements to create otherwise unnecessary overtime opportunities for their work unit. If management fails to challenge employees who appear to collude, a department could end up paying overtime rates for large amounts of work, which could have been performed at regular-pay levels. Departments and agencies have recognized this as a risk.

4.31 At both Correctional Service Canada and the Canada Border Services Agency, a small number of employees earned a disproportionate amount in overtime. At Correctional Service, 5 percent of overtime earners (562 out of 10,269 employees) used large amounts of both leave and overtime. Their overtime earnings accounted for 26 percent of the total amounts spent on overtime in the last two years (about $16 million out of $62 million). At Border Services we found 3 percent of the overtime earners (320 out of 9,820) fell into this category and accounted for about 15 percent of overtime expenses (about $6.6 million out of $44 million).

4.32 We asked managers to provide valid reasons for the overtime use by employees in this group who worked at the same sites and could

potentially collude. We found that managers were able to provide the requested information for the majority of employees. Managers cited understaffing, scheduling deficiencies, the need to respect collective agreements when granting leave, and workload issues as key causes of overtime. In addition they recognized possible abuse. In their responses, managers stated that they were already monitoring leave patterns for eleven Correctional Service employees and one Border Services employee.

4.33 We found that Correctional Service has very good systems to control overtime abuse. Timesheets require employees to indicate why they worked overtime, and management is able to determine the reasons with relative ease. Correctional Service conducted several reviews, which identified abuse as a relatively small problem. In response, Correctional Service has instituted an attendance awareness program, complete with red flags and guidelines for management action in the case of irregularities.

4.34 Although limited analysis of reasons for overtime had been conducted in the past, Canada Border Services Agency senior management begun tracking overtime use in October 2005. We noted some confusion among managers about which level of the Agency was responsible for analyzing leave and overtime use.

4.35 Recommendation. The Canada Border Services Agency should consider using the overtime management techniques employed by Correctional Service Canada and put in place better overtime and leave monitoring.

Canada Border Services Agency's response. We will take into consideration the recommendation. It should be noted that the audit did not identify any issues with regard to overtime abuse.

Acquisition cards are used inappropriately

4.36 Purchase orders—the traditional means that government departments use to obtain goods and services—cost the government about $50 to $100 more for each transaction than using a credit card. In December 1991, the federal government launched its acquisition card program. An acquisition card is a regular bank credit card for which the department, not the cardholder, takes on the obligation to pay. The cards are convenient for consolidating the procurement and payment of limited goods and services of low dollar value. Prompt payment of card account balances (that is, within seven days of billing

statement) triggers a rebate to the department. Payments that are thirty days overdue trigger interest charges.

4.37 The Auditor General's 1997 Report, Chapter 7, Acquisition Cards, reported on its audit about the controls that would be appropriate for the use of government acquisition cards. The audit found that departments were not prepared to manage the risks of acquisition cards. It also found that departments needed better training and control procedures and that the use of controls varied from organization to organization. Allowing more than one employee to share duties related to use of the acquisition card coupled with inadequate monitoring, recording, secondary scrutiny, auditing, and verification of card transactions were all seen as major risks.

4.38 In response to our 1997 audit, the Treasury Board established a new policy in 1998 that emphasized that departments need better controls when issuing and using acquisition cards. In addition departments need to improve monitoring, analysis, and the use of information provided by contractors in electronic format. Our 1999 follow-up noted progress, new monitoring, and control tools in departments, and a revised Treasury Board policy and management guide. We also noted the implementation of improved control practices to reduce risks.

4.39 One of our objectives for this audit was to determine whether controls were in place and acquisition cards were being used appropriately. In particular, we looked to see that

- card users had received training,
- only authorized users made purchases with the cards,
- only authorized goods and services were purchased, and
- spending limits were not exceeded or circumvented.

4.40 We audited a representative sample of card holders in each agency and reviewed their transactions for the last year. More information on our methodology can be found in **About the Audit.**

4.41 Compliance is a problem at the RCMP. The RCMP has about 4,300 acquisition cards in use. The control structure conforms to the Treasury Board requirements. As an added control, the RCMP has also made accounting services in each region responsible for monitoring card use, for ensuring compliance, and for distributing monthly cost allocations.

4.42 In 2003, the RCMP's internal audit unit carried out a review of the use of acquisition cards in one facility; this was followed by an agency-wide comptroller's review in 2004. The RCMP conducted routine monitoring and a study on contracting and procurement procedures, which identified a number of potential abuses and other risk areas. The RCMP found that

- cardholders were unfamiliar with the RCMP's policy for acquisition cards and that cards had been used to pay for meals, flowers, fuel, and travel;
- cards had been used by employees other than the cardholder; and
- the appropriate manager or other authorized employee had not confirmed that goods and services had been received or the actual cardholders had approved their own purchases.

4.43 Officials told us that the RCMP took remedial action to correct problems found by internal reviews, including revising processes, improving controls, and developing and providing training.

4.44 The most frequent misuses our examinations found at the RCMP were as follows:

- Thirty-six percent of cardholders made purchases for hospitality functions, gift plaques, flowers, and coffee room supplies (Exhibit 4.3).
- Nineteen percent of cardholders used the card for vehicle operating and maintenance expenses, which are not allowed by Treasury Board policy. At least some of these transactions (three percent) took place when the vendor rejected the special vehicle operating card, and no other payment alternative existed.
- The RCMP does not allow cardholders to purchase computer goods and services without prior approval by the regional informatics officer or unless the purchase is made from an approved supplier. Seventeen percent of cardholders made information technology purchases.
- We found one case where an individual made personal purchases for car insurance and a gym membership. The RCMP could not provide a receipt or contract for the gym membership, nor an adequate explanation for either purchase.
- We found one instance of splitting a purchase of cameras and equipment to evade controls, with the file annotated "bill under two separate billings," and two cases where records were in such disarray that the individual's file could not be audited.

Exhibit 4.3 RCMP—Use of acquisition cards for hospitality

We found one case where two thirds of the transactions on an acquisition card for fiscal year 2004–05 were for hospitality purchases such as gift plaques, engraving and framing, mugs, pins, and restaurant and catering bills for a total of $4,125 out of a total of $5,698 worth of purchases. Although the required receipts were not kept, a review by the RCMP of the hospitality expenses indicate that they were within Treasury Board Secretariat policy limits.

The purchases were made for and authorized by two different commanding officers who occupied this position sequentially. RCMP policy is clear that acquisition cards are not to be used as a method of payment for hospitality. RCMP policy also requires pre-approval from the Finance Branch.

According to the regional finance section, it was aware of non-compliant purchases seven months prior to our audit. They informed the cardholder that "hospitality charges were against policy and they were not to be on the VISA card." Nevertheless, the commanding officer claimed he had spending authority, and the charges were billed to the acquisition card.

Treasury Board Secretariat policy states that "Departmental policy must state clearly what constitutes abuse and wilful disregard of the operating policy and the consequences of these actions." The RCMP policy requires staff to "identify, document and take immediate action to stop any abuse and wilful disregard of directives. If necessary, cancel the acquisition card and inform the National Acquisition Card Coordinator."

The RCMP initiated action to ensure compliance in January 2006 after it had received our audit report.

4.45 We also found that at the RCMP, 21 percent of cardholders had not certified that goods and services had been received as is required. Documentation was missing or unsigned, and cardholders often verified that goods and services had been received, rather than having another person do this, as the rules require. This leaves the RCMP open to the risk of abuse if no one verifies transactions or if individuals sign for their own purchases

4.46 The use of acquisition cards for payment of vehicle operating and maintenance expenses is a particular difficulty. Treasury Board policy specifically states that the acquisition card must not be used for this purpose. However, Treasury Board Secretariat officials informed us that they encourage the use of acquisition cards for purchases that are not clearly identifiable or not defined as an operating or maintenance item for vehicles under the current motor vehicle policy, as long as other policy requirements for acquisition cards are met. The Treasury Board Secretariat has not amended its policy to say this is allowed. This has created a grey area for RCMP employees who must purchase vehicle parts and material for inventory and for specialized vehicle equipment, such as flashing lights, internal screens, and barriers, because the

Treasury Board Secretariat has not provided a definition of operation and maintenance expenses. When departments find rules impractical, but allow them to stand, it can eventually result in all the rules falling into disrepute and an overall lack of control. Treasury Board Secretariat officials told us they were already updating the relevant policies and had intended to take this problem into account.

4.47 Nine RCMP garage managers use acquisition cards to purchase automobile parts for vehicle maintenance. Better value might be achieved by competitive tendering for spare parts.

4.48 Finally, we determined that only about 25 percent of the RCMP employees in our sample had received training in the use of acquisition cards.

4.49 Canada Border Services Agency also has compliance problems. The Canada Border Services Agency has about 900 acquisition cards. The Agency uses a Canada Revenue Agency system to track card use. The headquarters finance unit of the Border Services Agency collects regional statistics on card use but does not scrutinize transactions systematically in detail.

4.50 We found evidence of training for less than 10 percent of the cardholders in our sample, since the new agency was created. Officials told us that 700 cardholders had been trained by predecessor organizations but could not provide us with evidence confirming this.

4.51 A great many of the non-compliant cases we found at the Canada Border Services Agency appeared to have occurred because corporate headquarters gave informal permission. We found that 25 percent of cardholders had purchased software or computer hardware, which was not permitted by departmental policy at the time, but which had been allowed for operational convenience. An additional 19 percent of cardholders had purchased vehicle maintenance or repair services, which is not allowed by Treasury Board policy. As was the case with the RCMP, the Border Services officials explained that suppliers sometimes refused the approved vehicle operating card; officials also claimed that the acquisition card was the most efficient purchasing method.

4.52 We also found that other regulations had not been followed.

- Ninety-eight percent of cardholders did not obtain three price quotes for purchases over $500, as the Agency required at the time of the audit. The Agency has since made this optional.

- Seventeen percent of cardholders made purchases over the $5,000 transaction limit specified by the Agency. We found one instance where cardholders split one transaction into two bills to evade controls.
- There were three cases where provincial sales tax was paid although the federal government is exempt, and where the cardholder simply recorded the entire amount as the purchase price rather than correcting the mistake. Agency officials noted that the amounts were small. Nevertheless, we remain concerned about the lack of care in recording transactions.
- The selection of one individual in our audit sample coincided with an internal investigation. Agency officials found that this individual made 61 questionable transactions (payments for home electricity bills, fuel and gasoline purchases, pharmacy bills, and a home alarm system), and the Agency cancelled the acquisition card. Because questionable transactions were not identified within three months of having been made, the Agency will be unable to claim insurance repayment for any wrongful transactions. This case indicates potential control weaknesses. Agency officials told us they would take other measures to recover any losses.

4.53 Correctional Service Canada has few controls, but few problems. There are about 1,000 acquisition cards in use at Correctional Service Canada. In total, Correctional Service spent $8.9 million on purchased goods and services through acquisition cards in the 2004 calendar year.

4.54 Controls are not as extensive at Correctional Service as at the RCMP. A report generated by regional coordinators identifies the total value of a purchase at a given time, the name of the store, and the date of purchase. However, the report does not list the individual items purchased. Although officials are aware of the risk of abuse, they have not taken steps to perform audit and inspection on a regular basis.

4.55 The last internal audit performed in 1998 identified some deficiencies, such as inappropriate uses of the card and lack of tracking of attractive items purchased with cards, such as television sets. It also noted that cardholders did not submit payment documentation, including receipts and bank statements, on time to the Agency's finance unit for payment, which resulted in interest charges.

4.56 We could not determine how many cardholders at Correctional Service have received training. However, we also found few non-compliant transactions; for example, purchasing forbidden goods,

splitting purchases, and exceeding the card spending limit made up less than one percent of transactions in each case. However, one of the few cases of non-compliance we found involved purchase splitting for large amounts.

4.57 We found that about one third of the cardholders had delinquency charges on their accounts for not making payment in a timely manner. For 35 percent of cardholders, there was no review or sign-off for one or more transactions. Correctional Service Canada allows cardholders to sign on their own behalf that goods and services have been received. Twenty-six percent of the cardholders in our sample did so. In one case, we found that an inmate had signed for the purchase. Officials told us that this happened when the inmate was mistakenly given the credit card slip to sign as an acknowledgement of the receipt of goods. These are obvious failures to separate duties, which are control weaknesses. Finally, even when there is a review of the statements, reviewing officials told us that they do not have information about every purchase, and they approve consolidated monthly transactions in bulk. This blind approval leaves room for abuse.

4.58 We identified few problems at Correctional Service Canada, but the lack of controls creates vulnerability to abuse.

4.59 Recommendation. The Royal Canadian Mounted Police, Correctional Service Canada, and the Canada Border Services Agency all should ensure that cardholders are given training regarding their responsibilities for the use of acquisition cards. Training should include known compliance problems, including a discussion of representative cases of abuse.

Canada Border Services Agency's response. The Canada Border Services Agency acknowledges that the training of cardholders is important and will continue to ensure that cardholders are appropriately trained. In addition, we will review the training documentation of legacy cardholders and provide additional training where necessary.

Correctional Service Canada's response. Correctional Service Canada remains convinced that adequate training is pivotal in the implementation of good practices and will ensure that all cardholders receive proper training.

RCMP's response. We agree. Currently the cardholder must sign an acknowledgement of their obligations upon receipt of the acquisition card. We also provide the cardholder and section 34 officer with a

document outlining his/her responsibility, as well as a copy of the acquisition card policy. A three-hour non-compulsory training session is offered to both the cardholder and the section 34 officer. Besides the acquisition card training, section 34 officers are provided with a Delegation of Authorities non-compulsory training session, which provides examples of potential cases of non-compliance to various policies. Both courses will be made mandatory in fiscal year 2006–07.

4.60 Recommendation. The Royal Canadian Mounted Police, Correctional Service Canada, and the Canada Border Services Agency all should ensure that the system for verifying purchases is fully implemented and the individuals who have signing authority actually verify the transactions.

Canada Border Services Agency's response. The Canada Border Services Agency can confirm that the necessary systems and processes are in place. We have also implemented an internal process where the responsibility centre manager reviews the monthly acquisition card statement to validate that the purchases presented for payment approval are for legitimate government business.

Correctional Service Canada's response. Correctional Service Canada agrees and will continue to ensure that cardholders are fully aware of, and approve, what has been purchased through the acquisition cards.

RCMP's response. We agree. All measures and processes are in place to ensure the proper control of the acquisition card purchases. The process requires that an acquisition card log must be reconciled with the acquisition card statement and signed by a section 34 officer. A Quality Assurance Guide was developed to assist the manager with his/her obligations of compliance to various applicable policies. Acquisition card transactions are monitored on a monthly basis by regional accounting services staff.

4.61 Recommendation. Correctional Service Canada and the Canada Border Services Agency should increase the level of review of transactions.

Canada Border Services Agency's response. The Canada Border Services Agency has already increased the resources to monitor cardholders' usage.

Correctional Service Canada's response. Correctional Service Canada's accounts verification procedures require a 100 percent verification of the invoices received from the credit card provider.

4.62 Recommendation. Correctional Service Canada should take corrective action regarding late-payment interest charges.

Correctional Service Canada's response. Effective December 2005, Correctional Service Canada has implemented a new process, in collaboration with the acquisition card provider, whereby transactions are processed faster and the monthly invoice paid within 14 days of receipt, thus eliminating the issuance of interest charges for late payments.

4.63 Recommendation. The Treasury Board Secretariat should define vehicle operating and maintenance expenses as part of its Policy Suite Renewal Project.

Treasury Board Secretariat's response. The Treasury Board Secretariat accepts the recommendation.

In order to appropriately address this recommendation, the Treasury Board Secretariat's Policy Suite Renewal Project will complete the following:

- The Fleet Management Directive will be updated to clearly define vehicle operating and maintenance expenses, as well as to outline when it is appropriate to use another method of payment rather than the Fleet Management Card (forecasted completion—September 2006).
- The Acquisition Card Directive will be updated to cross-reference the updated Fleet Management Directive (forecasted completion—December 2006).

Until both the Fleet Management and Acquisition Card directives are updated, the Treasury Board Secretariat will develop and issue a communiqué to the departments and agencies clarifying the appropriate use of the Fleet Management Card as a method of payment as it relates to the vehicle operating and maintenance expenses.

Compliance with contracting rules requires improvement

4.64 The three agencies included in our audit are responsible for administering almost 90,000 contracts a year; these contracts cost the government over $566 million per year. Correctional Service Canada accounts for the bulk of these contracts, and the breakdown of the dollar amounts in 2004 is as follows:

- Correctional Service awarded or let almost 79,000 contracts worth over $300 million.

- The RCMP let about 6,800 contracts worth $255 million.
- Border Services let about 2,000 contracts worth over $11 million.

4.65 In the federal government, Public Works and Government Services Canada contracts on behalf of other departments for most goods and some services; departments have authority to handle contracts up to a certain dollar amount. Public Works also has in place contracting tools that assist federal departments in the procurement of informatics services below $89,000. Officials at Public Works told us that when departments use those tools, each individual department becomes the contracting authority and takes on ultimate accountability. However, Public Works is responsible for ensuring that the tools are used in accordance with prescribed policies and regulations.

4.66 Audits by the Office of the Auditor General and internal audit units in many departments have found that contracting has been subject to abuse. In the past we have found widespread non-compliance with contracting rules, which endangered both value-for-money and the integrity of the departments involved. We therefore considered contracting to be an activity at risk.

4.67 We looked at contracts let by the three agencies from April 2003 to March 2005. Since Border Services had delegated contracting authority only since April 2004, we could only look at one year of contracts from that agency. We reviewed about 60 contracts from each agency and selected 30 at random. Another 30 were selected on the basis of "red flags" indicating possible abuse. Red flags included the following:

- contract amounts close to sole-sourcing dollar limits,
- contracts with amendments of large dollar value,
- contracts that appeared to be above agency authority limits, and
- contracts that showed signs of contract splitting.

Because part of the sample was selected judgmentally, results cannot be extrapolated directly to the overall population of contracts. Nevertheless, our expectation was that no more than 10 percent of contracts would be non-compliant.

4.68 **Most RCMP contracts complied with regulations.** The majority of the contracts we examined at the RCMP complied with government policies. In the last two years, the RCMP has made efforts to improve compliance: contracts above $25,000 are reviewed by

procurement personnel with appropriate authority. There is a post-contract review and a quality assurance program. These reforms were made, in part, in response to lapses in control over contracts related to pension administration, (which is covered in the November 2006 Report, Chapter 9, Royal Canadian Mounted Police—Pension and Insurance Administration).

4.69 We did, however note areas requiring improvement. For example, 16 of the 66 contracts we reviewed had compliance problems of one sort or another. Among the most significant were the following.

Sole-sourced contract—A contract for which the contracting authority does not seek competitive bids.

- In 2 of 26 **sole-sourced contracts**, an adequate reason for not using a competitive process was lacking. Both of these contracts involved services supporting security operations where the RCMP claimed that competitive tendering would not have been in the public interest. However, we did not find adequate support for this claim (Exhibit 4.4). Although neither the RCMP nor Public Works agreed with our finding, the RCMP pointed out that it no longer contracts for information technology services in the same manner as was used in 1 of these cases. Public Works also explained that it has made policy changes to address the situation.
- In 5 of 26 sole-source contracts, a proposal from the vendor identifying time goals, deliverables, and cost was lacking.
- In 7 out of 66 contracts, goods or services were delivered before the contract or its amendment was in place.

4.70 **Recommendation.** The Royal Canadian Mounted Police should define what "not in the public interest" means in the context of its contracting practices that involve exceptions for national security reasons and should educate staff accordingly.

RCMP's response. We agree. The RCMP policy is in complete accord with both TBS and PWGSC National Security Exception (NSE) guidelines. Requests for NSEs are rare and are always handled by senior (director level) procurement staff that are fully conversant with NSE requirements. In addition, all NSE requests must be made by the RCMP's Deputy Commissioner of Operations (ADM level) and must include a rationale (justification) that satisfies the concerns of PWGSC's Assistant Deputy Minister, Acquisitions. RCMP Procurement will continue to play a strong challenge role for all such requests, which will be evaluated on a case-by-case basis.

4.71 **Recommendation.** The Royal Canadian Mounted Police and Public Works and Government Services Canada should make greater use of contractors with pre-approved security clearances in order to increase competitiveness in classified areas.

PWGSC's response. Public Works and Government Services Canada agrees with this recommendation and will make greater use of contractors with pre-approved security clearances in order to increase competitiveness.

RCMP's response. We agree. The RCMP will continue to investigate and prepare lists of pre-cleared contractors where appropriate and where operational concerns over safety and security are not

Exhibit 4.4 The "not in the public interest" exception to contract competition was misapplied

Intelligence database

In the two Royal Canadian Mounted Police files we examined where staff used the reason that it was "not in the public interest" to solicit bids, we found that there was insufficient reason provided to warrant its use. In one case, an intelligence database was being expanded and needed to be maintained. The RCMP has used the same firm for 15 years to create and maintain this database. When we reviewed the file, we found no statement of work—only a proposal from the supplier and a claim that the supplier would have access to a secure data centre. This data centre—and the contractors working in it—were under direct RCMP supervision.

The RCMP recommended to Public Works that the contract be let without competition to preserve the continuity of personnel and to restrict knowledge of the system to "the small circle of individuals who would ensure the best interests of the RCMP and the Canadian public at large." Public Works accepted the RCMP rationale and used it to justify letting the contract to the incumbent firm.

However, continuity of personnel is not a valid reason for sole-sourcing a contract under *Government Contracts Regulations*. Moreover, while the need for security-cleared contracts is apparent, the claimed need for severe restrictions in the number of individuals with knowledge of the existence of the database is at variance with the security provisions in place. There were no codeword clearance or "need to know" restrictions in place, and contract personnel with only the lowest level of security clearance were allowed to work on the project.

At the time of our audit, Public Works told us the contractor selected was the only qualified supplier capable of performing the contract. This is at variance with their rationale stated when the contract was let and was not further supported by them.

It is not clear to us why a restricted call to secured vendors could not be used in this case. The value of the contract, including options, was $800,000.

Panic buttons

In another case, the RCMP wanted to buy panic buttons for diplomats, senior federal officials, and other protected persons. The RCMP claimed that this purchase had to be compatible with existing equipment, and only the current vendor could supply the right equipment. The RCMP said the requirement was urgent because the stock was running out and an election was pending. It also claimed that it was necessary to limit knowledge of the specifications of the system for security reasons.

Public Works accepted these claims and let the contract to the incumbent supplier without competition.

We do not understand how compatibility with existing systems could create compatibility problems since the components were to be built to an RCMP-designed specification. We further do not understand—nor could the RCMP explain—how a pending election affected the urgency of their requirement.

Finally, we do not understand why secrecy around this requirement was so extreme that other, security-cleared contractors could not have been asked for bids. Although the hardware and circuitry were revealed to the contractor, the actual communication codes were kept secret by the RCMP. In addition the security requirements checklist for the contract—certified by the RCMP—stated that: there were no communications or information security requirements, only the lowest level of information assets ("Protected A") would be accessed, that contractors required only the lowest level of security screening, and that unscreened persons could be used for portions of the requirement.

jeopardized. The direct costs associated with security clearances to the RCMP as well as to potential contractors is significant, and the clearance duration is limited. Therefore, the need for these types of lists will continue to be evaluated on a case-by-case basis.

4.72 **Border Services has contract compliance problems.** The Canada Border Services Agency became responsible for its contracting activities on 1 April 2004. The Agency is experiencing some difficulty in complying with contracting regulations.

4.73 The most significant area of non-compliance was for information technology services to support existing agency systems. Officials told us that as a result of restructuring the government in early 2004, the newly created Canada Border Services Agency was not able to use the contracting arrangements negotiated by its predecessor department, the Canada Customs and Revenue Agency. In order to meet what it viewed as operational requirements in the short term, Border Services used Public Works contracting services, including the **IPS Marketplace**, to "ensure uninterrupted professional support." Our sample contained ten cases using this contracting method.

IPS Marketplace—The Informatics Professional Services Marketplace is a procurement database, managed by Public Works, which allows federal departments to search for consultants based on a list of skills and experience.

4.74 In reviewing these files we found four cases that did not comply with the IPS Marketplace requirement that a minimum of three contractors be considered for the work. In addition to these non-compliant cases, we found other cases where contracting practices called into question whether there had been genuine competition. Examples of these questionable practices are as follows:

- In eight instances the file began with a request for a contract naming an individual who was already working for the Agency and who was subsequently awarded the contract. An example of a note on one of the files was "Complete Package for position for [name of consultant]." Some individuals had been employed by the Agency or its predecessor for over four years. Officials told us that the Agency's file naming system was "less than ideal," but its intent was not to retain the incumbent, but "to confirm CBSA's requirement for a resource to perform those functions."
- In a particular file, three individuals from the same firm were the only ones considered, although thirteen other consultants had been identified. The selected consultants included the individual with the highest cost—a daily rate of $610—while the individual with the lowest rate of $450 was not invited to bid. The search for a single senior systems analyst resulted in three contracts being awarded to these individuals on the same day. All three selected individuals were incumbents, one of whom had worked at Border

Services or its predecessor agency since 1985, and another since 1990.

- Files were missing documentation that would indicate why certain firms were eliminated or that would indicate requests for proposals had actually been sent to more than one firm. Officials told us that some firms had been eliminated because they had not responded to the request for proposal and that Border Services officials had reinforced with the contracting officers the need to document these facts on the file.

- In five cases, the incumbent had been employed by Border Services or its predecessor agency continuously on contract for several years, and in one instance, since 1985.

4.75 Officials told us that they have since put new supply arrangements in place, and work is under way for a long-term solution to provide information technology services on a competitive basis.

4.76 Overall, twenty-one of the sixty-two contracts we examined had compliance problems. In addition to improperly directing contracts to specific suppliers, these problems included

- two cases of failure to certify that funds were available to pay for the contract,

- inadequate description of the nature or goods or services to be provided,

- failure to meet other criteria for sole-sourcing a contract,

- one case of failure to certify that services had been received before making payment, and

- delivery of goods before a contract was in place.

4.77 The Canada Border Services Agency has taken a number of measures to further ensure compliance with contracting regulations and with the proper conduct of public business including the following:

- A Canada Border Services Agency Contracting Policy was approved by the Agency's Executive Management Committee and distributed in fall 2005.

- Two national training sessions (April 2005 and September 2005) were conducted for all headquarters and regional contract officers.

A CBSA Contract Review Committee (CRC) was created in fall 2005 and has met. The CRC has representatives from the various branches located in headquarters, as well as two regional representatives. The mandate of the CRC includes analyzing trends in contracting as well as providing direction for agency-wide contracting practices (such as information technology services).

4.78 Correctional Service Canada also has compliance problems. We found that Correctional Service had many of the same difficulties as the other two agencies. The most significant problem was misuse of sole-source contracting. Four of the twenty-one contracts that we examined, which had been awarded on a sole-source basis, did not meet criteria for exemption from competition.

4.79 Overall, we found that twenty-five of sixty contracts at Correctional Service Canada had problems with compliance, including the following:

- failure to certify the funds were available to pay for the contract;
- failure to maintain proper contract records;
- delivery of goods and services before the contract was in place;
- lack of a proposal from the vendor specifying goals, deliverables, and cost; and
- one instance where a contract was awarded to a firm whose bid had not received the highest rating in the evaluation process.

4.80 Recommendation. Correctional Service Canada should implement a quality assurance system for contracting.

Correctional Service Canada's response. Correctional Service Canada has taken action to improve our quality assurance on contracts and purchases. CSC recently reviewed and strengthened our existing formal contract challenge mechanism. CSC has developed new monitoring tools to review contracting files before approval. CSC has also revised its contracting training course and made the course mandatory for managers with signing authority. Finally, CSC is supporting the TBS certification program for material management officers, and we will ensure that our people working in material management are properly trained to fully exercise their duties.

Conclusion

4.81 The Royal Canadian Mounted Police, Correctional Service Canada, and the Canada Border Services Agency all have the required programs to support ethical conduct and awareness of ethical problems and to support disclosure of wrongdoing.

4.82 Although programs may be in place, relatively few employees report having received specific training and awareness of values, and awareness of the ethics programs appears low. Survey results about disclosing wrongdoing internally are mixed. The majority of employees in the three organizations reviewed in this chapter say they would be willing to report wrongdoing, but they are much less confident that their co-workers would be willing to do this. Willingness to report depends on employees' perceptions that management will take action and that those who report the wrongdoing will be respected. The survey shows that employees perceive support from management as only moderately high at the RCMP and low at both Correctional Service Canada and the Canada Border Services Agency.

4.83 The internal audit units of the three organizations have included areas of overtime and leave, acquisition cards, and contracting in their risks assessments. The internal audit units perform audits of selected items.

4.84 Compliance performance at the three organizations is mixed. Leave abuse is a relatively insignificant cause of overtime use. We also found little actual abuse of acquisition cards for the benefit of the cardholder. However, all three agencies need to improve training and controls over acquisition card use. The RCMP and Border Services had large numbers of cardholders who had made transactions that did not comply with the policies. Correctional Service had fewer instances of misuse, but controls were weak.

4.85 Border Services and Correctional Service had compliance difficulties with contracting, and all three agencies had let non-competitive contracts without adequate justification. This decreased the agencies' ability to show fairness to all suppliers. We raised a similar observation in our May 2006 Status Report, Chapter 4, Canadian Firearms Program. We also raise it elsewhere in this Report, Chapter 9, Pension and Insurance Administration—Royal Canadian Mounted Police.

Subsequent Events

In September 2006, we reviewed our findings and recommendations with each audited organization. They reported that progress had been made in addressing audit findings, especially those related to the use of acquisition cards.

Royal Canadian Mounted Police. The Commissioner of the RCMP issued a directive to his senior executive team in March 2006 to reinforce how serious the misuse of acquisition cards was. He also directed that after-the-fact approvals will not be given.

In addition, there have been messages addressed to all staff and additional messages to financial staff to remind them of their responsibilities.

The RCMP has taken steps to increase monitoring of compliance and to take corrective action. A national working group has been established to oversee these actions.

The RCMP also worked with the Treasury Board Secretariat to resolve policy problems related to the use of acquisition cards for vehicle maintenance.

Canada Border Services Agency. The Canada Border Services Agency has made a number of improvements in the administration of acquisition cards:

- it has identified improved training materials and is working to provide them to staff,
- it has begun to develop staff notices and reminders about staff not paying provincial sales tax and about managers verifying transactions, and
- it has increased the monitoring of the use of cards.

It also reported that it has created a values and ethics action plan intended to take into account findings of the audit related to the agency.

Correctional Service Canada. Correctional Service Canada has redesigned its acquisition card system. It has also retrained all managers, cardholders, and support staff on the new system, including their roles and responsibilities in the use of the card.

Treasury Board Secretariat. The Treasury Board Secretariat issued new fleet management directives and a manager's handbook effective 1 November 2006, which among other matters, addresses the findings

of our audit. The new policy makes it clear how staff are to treat supplies bought for inventory and how they are to deal with exceptional cases where vendors do not accept the fleet credit card.

Public Works and Government Services Canada. Our audit of the Canadian Firearms Program, tabled in our May 2006 Status Report, presented findings about the purchase of information technology services similar to those of this audit. Public Works and Government Services Canada has already informed both the Standing Committees on Government Operations and Estimates and Public Accounts that it had taken action on those earlier findings. The Department testified that its actions involved training users in accountabilities and policies, increasing monitoring, and, where appropriate, restricting the use of purchasing tools for information technology services.

About the Audit

Objectives

The objectives of the audit were to

- determine the adequacy of the design and operation of programs supporting ethical conduct and awareness of ethical problems in areas that have an impact on resource management;
- determine the adequacy of the design and operation of processes in place to respond to internal disclosures made by employees within an organization;
- determine whether internal audit adequately supports compliance; and
- determine whether controls on contracting, acquisition cards, and overtime and leave are adequate.

Scope and approach

The audit was limited to the Royal Canadian Mounted Police, the Canada Border Services Agency, and Correctional Service Canada. For overtime and leave use, only the Canada Border Services Agency and Correctional Service Canada were examined.

To examine values and ethics programs we reviewed documents and records of all three agencies. We also conducted a survey of incumbent members of the three agencies. Non-management staff members were surveyed. The sampling strategy used was a non-proportional stratified sample with approximately 300 surveys sent to each agency. A total of 178 surveys were returned from the RCMP, 90 from Correctional Service Canada, and 159 from the Canada Border Services Agency. The respective response rates were 59 per cent, 30 percent, and 53 percent. The overall response rate was 50 percent. Non-sampling error due to non-response was negligible for the RCMP and the Canada Border Services Agency, but the 33 percent response rate from Correctional Service Canada was of moderate concern. The potential for minor non-response bias should be considered when interpreting the result for that agency. Overall estimates are accurate with plus or minus 4.0 percent 19 times out of 20. The individual confidence intervals for the RCMP, Correctional Service Canada, and the Canada Border Services Agency are 6.4 percent, 9.1 percent, and 6.5 percent respectively. Overall estimates reported in the chapter have been appropriately weighted.

The examination of each agency's controls for the contracting process was based on a selection of about 60 contracts from each department. The selection was partially based on random sampling, and partially on the basis of "red flags" for abuse such as multiple contracts to the same vendor close to cut-off amounts, which could indicate contract splitting. We expected to find no more than 10 percent of the contracts to be non-compliant.

We examined each contract file for adequacy of the documentation that is required for contracts, adequacy, and fairness of competition; appropriate financial sign-offs; and adequacy of justification for amendments. We discussed any inadequacies with management to understand if there was justification for apparent non-compliance.

The examination of overtime and leave use was based on data-mining of computerized employee pay and leave records. We examined these records for patterns indicating possible abuse. We then consulted with managers to determine possible legitimate causes for patterns. We also consulted with managers to determine what analyses they had performed and what controls they had in place.

The examination of acquisition-card use was conducted by making a random selection of about 60 card holders from each agency and then reviewing their transaction records for the current year. Cardholders were asked to explain any potentially non-compliant transactions. Officials were interviewed to determine what controls over card use were in place.

Criteria

We expected to find that the following criteria were being employed by the three agencies reviewed during this audit.

- The deputy head of each organization should "encourage and maintain dialogue" on values and ethics.
- Structures to implement the *Values and Ethics Code for the Public Service* or the relevant service code of conduct would be in place.
- A senior official would have been designated to oversee the values and ethics program of the Agency.
- The required reports to the Office of Values and Ethics were filed.
- The three agencies should be aware of the kind of ethical breakdowns that occur, how frequently they occur, and where they occur.
- The three agencies should target values and ethics programs to target local key challenges, as follows:
    - the three agencies should have a plan to provide training to target audiences,
    - the three agencies should know how many people are receiving training and how they match the assessed need, and
    - the three agencies should be aware of what the training is intended to achieve.
- There should be an analysis of requirements for contracted goods and services.
- Contracts should be based on fair and equitable competition.
- Contracts that are sole-sourced should meet at least one of the four exceptions listed in the *Government Contracts Regulations*.
- Goods and services paid for, through contracts, should be delivered.
- Officers signing off section 34 of the *Financial Administration* Act should have adequate proof that the goods and services contracted for were received.
    - The price invoiced by the vendor should be as specified in the contract, and the terms of the contract should be met.
- There should be a regular review of overtime usage and corrective action in the event of irregularities.
    - Managers should keep overtime to a minimum.
    - Clear standards should exist for justifying overtime.
    - Economical alternatives to overtime should be considered and used.

- There should be systems in place for approving, authorizing, and monitoring overtime and leave usage.
- There should be an analysis conducted on workflows.
- There should be an analysis conducted on the classification and levels of staff assigned to work units.
- There should evidence of management monitoring of the work demands and the available staff, and plans to rectify any imbalance.

- The three agencies should ensure that
  - internal mechanisms and assistance are in place to allow staff to bring forward information concerning wrongdoing in the workplace,
  - a senior official receives and investigates disclosures about wrongdoings in an appropriate and timely fashion,
  - employees are fully informed of the internal disclosure process in their agency, and
  - there is an alternative system for cases where the staff believe an issue cannot be discussed in their own agency.
- The three agencies should ensure that
  - they have an effective, independent, and objective internal audit unit that is properly resourced to provide sufficient and timely assurance services; and
  - they incorporate risk-based planning into internal audit projects; and their internal audit unit provides assurance to senior management about the effectiveness of the department's risk-management, control, and governance processes.

Audit work completed

Audit work for this chapter was substantially completed on 10 February 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 4. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Organizations' responses
Compliance in high-risk activities	
4.35 The Canada Border Services Agency should consider using the overtime management techniques employed by Correctional Service Canada and put in place better overtime and leave monitoring. (4.28–4.34)	**Canada Border Services Agency's response.** We will take into consideration the recommendation. It should be noted that the audit did not identify any issues with regard to overtime abuse.
4.59 The Royal Canadian Mounted Police, Correctional Service Canada, and the Canada Border Services Agency all should ensure that cardholders are given training regarding their responsibilities for the use of acquisition cards. Training should include known compliance problems, including a discussion of representative cases of abuse. (4.36–4.58)	**Canada Border Services Agency's response.** The Canada Border Services Agency acknowledges that the training of cardholders is important and will continue to ensure that cardholders are appropriately trained. In addition, we will review the training documentation of legacy cardholders and provide additional training where necessary. **Correctional Service Canada's response.** Correctional Service Canada remains convinced that adequate training is pivotal in the implementation of good practices and will ensure that all cardholders receive proper training. **RCMP's response**. We agree. Currently the cardholder must sign an acknowledgement of their obligations upon receipt of the acquisition card. We also provide the cardholder and section 34 officer with a document outlining his/her responsibility, as well as a copy of the acquisition card policy. A three-hour non-compulsory training session is offered to both the cardholder and the section 34 officer. Besides the acquisition card training, section 34 officers are provided with a Delegation of Authorities non-compulsory training session, which provides examples of potential cases of non-compliance to various policies. Both courses will be made mandatory in fiscal year 2006–07.

Recommendation	Organizations' responses
4.60 The Royal Canadian Mounted Police, Correctional Service Canada, and the Canada Border Services Agency all should ensure that the system for verifying purchases is fully implemented and the individuals who have signing authority actually verify the transactions. **(4.36–4.58)**	**Canada Border Services Agency's response.** The Canada Border Services Agency can confirm that the necessary systems and processes are in place. We have also implemented an internal process where the responsibility centre manager reviews the monthly acquisition card statement to validate that the purchases presented for payment approval are for legitimate government business. **Correctional Service Canada's response.** Correctional Service Canada agrees and will continue to ensure that cardholders are fully aware of, and approve, what has been purchased through the acquisition cards. **RCMP's response.** We agree. All measures and processes are in place to ensure the proper control of the acquisition card purchases. The process requires that an acquisition card log must be reconciled with the acquisition card statement and signed by a section 34 officer. A Quality Assurance Guide was developed to assist the manager with his/her obligations of compliance to various applicable policies. Acquisition card transactions are monitored on a monthly basis by regional accounting services staff.
4.61 Correctional Service Canada and the Canada Border Services Agency should increase the level of review of transactions. **(4.36–4.58)**	**Canada Border Services Agency's response.** The Canada Border Services Agency has already increased the resources to monitor cardholders' usage. **Correctional Service Canada's response.** Correctional Service Canada's accounts verification procedures require a 100 percent verification of the invoices received from the credit card provider.
4.62 Correctional Service Canada should take corrective action regarding late-payment interest charges. **(4.36–4.58)**	**Correctional Service Canada's response.** Effective December 2005, Correctional Service Canada has implemented a new process, in collaboration with the acquisition card provider, whereby transactions are processed faster and the monthly invoice paid within 14 days of receipt, thus eliminating the issuance of interest charges for late payments.

Recommendation	Organizations' responses
4.63 The Treasury Board Secretariat should define vehicle operating and maintenance expenses as part of its Policy Suite Renewal Project. **(4.36–4.58)**	**Treasury Board Secretariat's response.** The Treasury Board Secretariat accepts the recommendation. In order to appropriately address this recommendation, the Treasury Board Secretariat's Policy Suite Renewal Project will complete the following: • The Fleet Management Directive will be updated to clearly define vehicle operating and maintenance expenses, as well as to outline when it is appropriate to use another method of payment rather than the Fleet Management Card (forecasted completion—September 2006). • The Acquisition Card Directive will be updated to cross-reference the updated Fleet Management Directive (forecasted completion—December 2006). Until both the Fleet Management and Acquisition Card directives are updated, the Treasury Board Secretariat will develop and issue a communiqué to the departments and agencies clarifying the appropriate use of the Fleet Management Card as a method of payment as it relates to the vehicle operating and maintenance expenses.
4.70 The Royal Canadian Mounted Police should define what "not in the public interest" means in the context of its contracting practices that involve exceptions for national security reasons and should educate staff accordingly. **(4.64–4.69)**	**RCMP's response.** We agree. The RCMP policy is in complete accord with both TBS and PWGSC National Security Exception (NSE) guidelines. Requests for NSEs are rare and are always handled by senior (director level) procurement staff that are fully conversant with NSE requirements. In addition, all NSE requests must be made by the RCMP's Deputy Commissioner of Operations (ADM level) and must include a rationale (justification) that satisfies the concerns of PWGSC's Assistant Deputy Minister, Acquisitions. RCMP Procurement will continue to play a strong challenge role for all such requests, which will be evaluated on a case-by-case basis.

Recommendation	Organizations' responses
4.71 The Royal Canadian Mounted Police and Public Works and Government Services Canada should make greater use of contractors with pre-approved security clearances in order to increase competitiveness in classified areas. **(4.64–4.69)**	**PWGSC's response.** Public Works and Government Services Canada agrees with this recommendation and will make greater use of contractors with pre-approved security clearances in order to increase competitiveness. **RCMP's response.** We agree. The RCMP will continue to investigate and prepare lists of pre-cleared contractors where appropriate and where operational concerns over safety and security are not jeopardized. The direct costs associated with security clearances to the RCMP as well as to potential contractors is significant, and the clearance duration is limited. Therefore, the need for these types of lists will continue to be evaluated on a case-by-case basis.
4.80 Correctional Service Canada should implement a Quality Assurance System for contracting. **(4.72–4.79)**	**Correctional Service Canada's response.** Correctional Service Canada has taken action to improve our quality assurance on contracts and purchases. CSC recently reviewed and strengthened our existing formal contract challenge mechanism. CSC has developed new monitoring tools to review contracting files before approval. CSC has also revised its contracting training course and made the course mandatory for managers with signing authority. Finally, CSC is supporting the TBS certification program for material management officers, and we will ensure that our people working in material management are properly trained to fully exercise their duties.

Report of the Auditor General of Canada to the House of Commons—November 2006

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Chapter 5
Relocating Members of the Canadian Forces, RCMP, and Federal Public Service

Office of the Auditor General of Canada



2006



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Auditor General of Canada

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Chapter 5

Relocating Members of the Canadian Forces, RCMP, and Federal Public Service

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.



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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-5E
ISBN 0-662-44369-1

Chapter

5

Relocating Members of the Canadian Forces, RCMP, and Federal Public Service

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Relocating Members of the Canadian Forces, RCMP, and Federal Public Service

Main Points

What we examined

The Integrated Relocation Program was designed to improve the quality of life of transferred members of the Canadian Forces, the RCMP, and the federal public service. It does this by providing flexible relocation benefits and reimbursing reasonable relocation expenses. We examined how the government awarded the current contracts. We looked at each stage of the process to determine whether government contracting policies and regulations had been respected. We also examined the extent to which the Treasury Board Secretariat and the departments involved had established appropriate measures of the contracts' performance.

While this chapter includes the names of various contractors, it must be noted that our conclusions about management practices and actions refer only to those of government departments. The rules and regulations we refer to are those that apply to public servants; they do not apply to contractors. We did not audit the records of the private sector contractors. Consequently, our conclusions cannot and do not pertain to any practices that contractors followed. We did not assess individual expense claims made by relocated employees or activities related to the moving of household goods.

We conducted our audit in response to a November 2005 request by the Public Accounts Committee.

Why it's important

The relocation program handles about 15,000 relocations a year across the government, the RCMP, and the Canadian Forces, at a cost of about $272 million in 2005.

The government has said that the purpose of the relocation program is to improve the quality of life for transferred employees and reduce the detrimental effects of relocation on departmental operations. Knowing how to gauge the program's success at meeting these goals is important for the government in a contract of this size. Ensuring that the public servants involved in awarding the contract have diligently followed the rules and applied the principles of fairness and transparency is vital to the credibility of the government's procurement process.

What we found

- We have concluded for two reasons that the contracts were not tendered in a fair and equitable manner. First, some of the business volumes incorporated into the request for proposal by the Treasury Board Secretariat, the Canadian Forces, and the RCMP contained materially incorrect information. Second, although PWGSC followed its established processes, these steps were not sufficient—particularly when concerns had been raised—to offset an unfair advantage the incumbent bidder had attained through its work on a prior contract and to ensure that all bidders in the tendering process had access to correct and complete information.
- Except for an inappropriate comparison of bids during the evaluation process, the evaluation of the technical portion of the bids was conducted in accordance with the Treasury Board Contracting Policy.
- Neither the Treasury Board Secretariat nor departments have developed performance measures to demonstrate whether the Integrated Relocation Program is achieving its objectives or has realized any cost savings.
- National Defence has not established adequate controls to ensure that amounts reimbursed to the contractor for relocation services provided to transferred Canadian Forces members represent valid payments and are consistent with the relocation policy.
- Members of the Canadian Forces have been charged amounts for property management services in excess of rates established in the contract.

The Treasury Board Secretariat and the departments have responded. The Treasury Board Secretariat, the RCMP, National Defence (Canadian Forces), and Public Works and Government Services Canada have agreed with our recommendations. Their detailed responses follow the recommendations in the chapter.

Introduction

The Integrated Relocation Program

5.1 The objective of the Integrated Relocation Program is to provide a full range of relocation services to members of the Canadian Forces and Royal Canadian Mounted Police (RCMP) and other federal employees in the most efficient and flexible manner, at the most reasonable cost to the government, and with the least disruption to departmental operations.

5.2 The Integrated Relocation Program began as a pilot program in April 1999 and became a permanent program in June 2002 for the Canadian Forces, the RCMP, and parts of the federal public service.

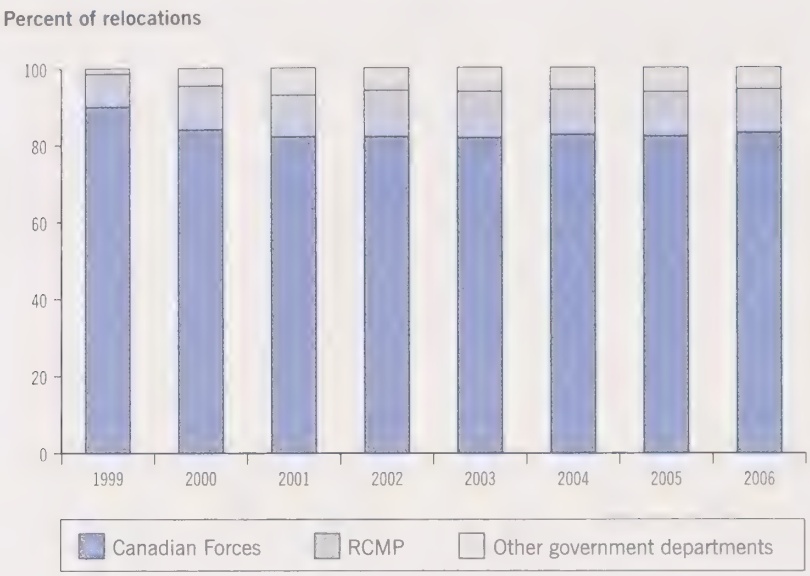
5.3 In April 1999, Royal LePage Relocation Services (RLRS) was awarded the contract, through a competitive process, to administer the pilot program. In December 2002, the company was awarded the contract for the permanent program; however, the government later cancelled this contract. In November 2004, following another competitive process, the company was awarded the two current contracts for the Integrated Relocation Program. The contract for the Canadian Forces was valued at $125 million, and the contract for the RCMP and Government of Canada employees was valued at $29.2 million. The contract values include RLRS administration fees only. Both contracts run until November 2009, with an option for a two-year extension.

5.4 About 15,000 relocations take place annually. Of these, about 83 percent are members of the Canadian Forces, 11 percent are members of the Royal Canadian Mounted Police, and 6 percent are employees of other government departments, agencies, and Crown corporations (Exhibit 5.1).

Roles and responsibilities

5.5 Departmental roles and responsibilities are set out in the two contracts issued under the Integrated Relocation Program. They are also established by government policies that require departments to measure and report on program results (Exhibit 5.2). As the government's contract authority, Public Works and Government Services Canada (PWGSC) has a responsibility to ensure that procurement activities are open, fair, and honest and that all potential suppliers are subject to the same conditions. PWGSC is accountable for the integrity of the complete procurement process, including all actions taken within the process.

Exhibit 5.1 The Canadian Forces has the majority of relocations



Source: The Treasury Board Secretariat

Exhibit 5.2 Key responsibilities for the Integrated Relocation Program

Treasury Board	• Approves the Integrated Relocation Program. • Approves departmental relocation policies.
Treasury Board Secretariat	• As project authority for the program, has overall responsibility for the program. • Authorizes and approves reimbursement claims that exceed established limits. • Is responsible for all matters regarding the scope of the technical work in the program contracts (for example, services offered by Royal LePage Relocation Services).
Public Works and Government Services Canada	• Is the contract authority for the program. • Liaises with Royal LePage Relocation Services on behalf of the departmental authorities about performance and compliance issues.
Departmental authorities—National Defence and the Royal Canadian Mounted Police	• Are responsible for the technical content and for monitoring work conducted under the program contracts. • Are responsible for approving all relocation-related payments.
Royal LePage Relocation Services	• Provides relocation consulting and administrative services, including planning, marketing assistance, and destination services. • Pays third-party service providers (for example, lawyers, real estate agents, and appraisers). • Pays advances and allowances, and settles all relocation costs claimed by employees/members (for example, meals, hotel, and mileage).
Third-party service providers—real estate agents, appraisers, lawyers, and inspectors	• Provide services to employees/members being relocated.

Source: Public Works and Government Services Canada

Administration of the program

5.6 The basic benefits in the Canadian Forces, RCMP, and Government of Canada relocation policies are similar, although the administration of the policies differs considerably.

5.7 The Canadian Forces relocation policy is delivered to members through Royal LePage Relocation Services consultants located on Canadian Forces bases throughout the country. All relocation files are maintained in RLRS offices located on these bases until files are completed and closed by RLRS. The Canadian Forces do not review closed files, original receipts, or detailed explanations of the costs incurred. RLRS pays most non-administrative ("flow through") costs associated with relocations (for example, employee advances, relocation allowances, real estate commissions, and legal fees) on behalf of National Defence (Canadian Forces). Up until 1 July 2006, RLRS had been reimbursed daily through electronic credits made by the Receiver General on behalf of National Defence (Canadian Forces) to a **zero balance account** held in the name of RLRS. Since 1 July, National Defence (Canadian Forces) has assumed complete control for initiating payments to the zero balance account.

Zero balance account—An account with a commercial bank that allows Royal LePage Relocation Services to pay suppliers and Canadian Forces personnel on behalf of National Defence for costs associated with the relocation. At the end of each business day, the contractor reports to the Receiver General the amount expended from the account, and the Bank of Canada reimburses the appropriate amount. For example, if the contractor issues payments for $1 million from the account on a given day, the Bank of Canada deposits $1 million the next banking day, which effectively "zeros out" the account.

Using this account to handle payments was intended to reduce National Defence's financial administration and interest payments to the contractor.

5.8 Members of the RCMP and employees of government departments do not have RLRS consultants in their detachments or offices. Consultations between a member and RLRS are conducted by phone or through other electronic means. Closed files are sent to the member's new posting. Any reconciliation or verification of relocation files is done at the regional or divisional level by RCMP relocation reviewers.

5.9 Administrative and "flow through" costs associated with each RCMP relocation file are incorporated into a billing arrangement that consists of three payments. The bills are based on estimates by RLRS of the move's costs and are submitted to RCMP relocation reviewers for approval. The RCMP does not use a zero balance account.

5.10 In accordance with the contracts, the contractor receives an administration fee for the relocation of each Canadian Forces or RCMP member or other government employee. Third-party services provided to the transferee are to be charged according to the ceiling rates for these services as set out in the contract.

Focus of the audit

5.11 The focus of our audit was to assess whether the two contracts issued in 2004 for the Integrated Relocation Program were awarded

according to government contracting policies and the Public Works and Government Services Canada Supply Manual.

5.12 We assessed the extent to which the Treasury Board Secretariat and the departments had established appropriate performance measures for the contracts. We also examined financial controls of National Defence (Canadian Forces) and the RCMP for administration of the contracts.

5.13 We did not assess individual claims made by relocated employees/members or activities related to the removal of household goods. Nor did we assess how Royal LePage Relocation Services administered the Integrated Relocation Program.

5.14 While this chapter includes the names of various contractors, it must be noted that our conclusions about management practices and actions refer only to those of government departments. The rules and regulations we refer to are those that apply to public servants; they do not apply to contractors. We did not audit the records of the private sector contractors. Consequently, our conclusions cannot and do not pertain to any practices that contractors followed.

5.15 Departments and agencies included in the audit were

- National Defence (Canadian Forces),
- Public Works and Government Services Canada,
- the Royal Canadian Mounted Police, and
- the Treasury Board Secretariat.

5.16 More information on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Contracting for the Integrated Relocation Program

The request for proposal contained incorrect and misleading information

5.17 There was one request for proposal (RFP) issued by PWGSC for the Canadian Forces and the RCMP/Government of Canada contracts. We expected that the RFP would have set out a clear and accurate description of the statement of work that the winning bidder was expected to provide, and that the contracts would have been tendered in a fair, open, and transparent manner. We also expected

that all bids would have been evaluated in a fair and consistent manner against the criteria described in the RFP.

5.18 The RFP's evaluation procedures and criteria instructed bidders to quote one price for administering relocation files and a second price, based on six ceiling rates, for relocation services to be provided by third-party service providers. These third-party services include

- property management services,
- appraisals,
- building inspections,
- realtor services,
- rental search services, and
- legal services.

5.19 In accordance with the criteria established for evaluating the bids, both prices were combined to generate a total bid price. The total bid price and the bidder's total technical score were then combined using predetermined evaluation criteria that assigned a weighting of 25 percent to the price proposal and 75 percent to technical merit. The proposal with the highest combined rating of technical merit and price would be recommended for awarding of the contract.

5.20 A basic principle of government procurement is that bidders can rely on the completeness, accuracy, and integrity of the information in the RFP because their proposal is based on that information (Exhibit 5.3). This is particularly important when an incumbent service provider is one of the bidders.

5.21 As part of our audit, we reviewed the third-party service business volumes set out in the RFP. We noted a wide gap between actual business volumes in the program and some of the volumes set out in the RFP. In particular, we noted a wide discrepancy in the business volumes for property management services.

Exhibit 5.3 Guiding principles of procurement

Integrity—PWGSC supply activities will be open, fair, and honest.

Equal treatment—PWGSC will ensure that all potential suppliers of a particular requirement are subject to the same conditions.

Accountability—PWGSC is accountable for the integrity of the complete procurement process including all actions taken within the process; this also applies to actions originating from the client that are not in compliance with the Treasury Board or PWGSC policies, or applicable legislation.

Source: Public Works and Government Services Canada Supply Manual

5.22 Property management services apply to relocations when an employee owns a home and wishes to rent it rather than sell it. These services include such things as screening and monitoring tenants, collecting rent, and conducting property inspections.

5.23 For the purpose of evaluating financial proposals, bidders were required to provide an individual unit price for property management services, based on ceiling rates. The individual unit price was applied to the business volume stated in the RFP to arrive at a total price for property management services.

5.24 Based on information provided by National Defence, we found that the request for proposal had incorrectly stated the proportion of Canadian Forces relocations (60 percent or some 7,200 relocations each year) using property management services. Bidders, therefore, based their proposals for these services on those numbers. According to Canadian Forces statistics, however, only 183 of about 81,000 moves between 1999 and 2005 (about 0.22 percent) had actually used these services.

5.25 Similarly, the request for proposal also incorrectly stated the proportion of RCMP and Government of Canada relocations using property management services (450 RCMP relocations and 280 Government of Canada relocations annually). In fact, between 1999 and 2005, only 2 of almost 11,000 RCMP relocations and 4 of over 5,300 Government of Canada relocations used property management services.

5.26 In preparing its bid for the Canadian Forces contract, Envoy Relocation Services Inc., one of the two bidders for the Canadian Forces contract, did not have information on the actual program volumes for third-party services. Envoy prepared its bid based on business volumes stated in the request for proposal for the contract. It priced property management services for some 7,200 Canadian Forces moves annually for the five-year contract period and an optional two years at $48.7 million. As the incumbent service provider, Royal LePage Relocation Services had access to actual program volumes for third-party services because it had provided relocation services to the government during the four-year pilot Integrated Relocation Program beginning in April 1999 and also for the period beginning in 2002 under the contract that was terminated. The RLRS bid was substantially less. Following the bid evaluation process, a contract was issued to RLRS with a ceiling rate of zero percent for property management services, indicating that these services were to be provided without cost to Canadian Forces members.

5.27 In reviewing correspondence related to the request for proposal, we noted that a potential bidder had asked PWGSC to provide figures showing the actual use of property management services by members of the Canadian Forces and RCMP and by Government of Canada employees for the past five years. PWGSC's response, based on representations from the Canadian Forces, RCMP, and the Treasury Board Secretariat, was that the figures were not available. In our view, National Defence (Canadian Forces) and the RCMP should have been able to provide the correct information. PWGSC, as the contracting authority, and the Treasury Board Secretariat, as the project authority, should also have been able to provide these figures and had an obligation to do so.

5.28 We concluded for two reasons that the Canadian Forces and the RCMP/Government of Canada contracts were not tendered in a fair and equitable manner. First, the business volumes incorporated into the request for proposal by the Treasury Board Secretariat as project authority and by the departmental authorities (National Defence and the RCMP) contained materially incorrect information on the volumes for property management services. Second, although PWGSC followed its established processes, these steps were not sufficient—particularly when concerns had been raised—to offset an unfair advantage the incumbent bidder had attained through its work on a previous contract and to ensure that all bidders in the tendering process had access to correct and complete material information. Accordingly, the tendering process did not adhere to the government policy requirement for fair and transparent competitive tendering or to the PWGSC Supply Manual.

Warning signs that the fairness of the procurement process had been compromised were not acted on

5.29 We reviewed the RFP process for the 2004 contract award to determine whether there were any signs that the fairness of the procurement process may have been compromised and, if so, whether PWGSC had taken appropriate action.

5.30 We noted instances during the process where bidders raised questions with PWGSC concerning property management services. These included questions about apparent inconsistencies in the percentage of relocations that would require property management services and a request for actual business volumes for property management services over the past five years.

5.31 Inconsistencies in the request for proposal. Information in the request for proposal stated that 60 percent of Canadian Forces members were renters and 40 percent were homeowners. One potential bidder notified PWGSC that the evaluation criteria in the RFP applied the percentage of renters (60 percent) to property management services—a service that only homeowners could use.

5.32 In its response, PWGSC confirmed that property management services apply only to homeowners not selling their homes, but it stated that for evaluation purposes, the percentage figure (60 percent) would not be changed. In our view, the response provided did not adequately address the potential bidder's concern.

5.33 Accuracy of business volumes questioned. During the RFP process, a potential bidder questioned the information on the number of Canadian Forces relocations that would require property management services. The questioner stated that the rate of use for this service was much lower and asked for statistics on the actual use of this service. Another potential bidder requested the actual volume of relocations using property management services. PWGSC subsequently communicated to all bidders that actual volumes were not available for the past five years but the estimated number of annual moves could be found in the RFP. In our view, this response did not adequately address the concern raised.

The bids for providing property management services varied widely

5.34 We reviewed PWGSC's evaluation of the financial component of the bids received in response to the request for proposal for both contracts. We expected that the evaluation would be conducted according to the government's contracting policy and the PWGSC Supply Manual.

5.35 As required by the contracting policy, each bid was individually evaluated against the criteria set out in the RFP. While PWGSC evaluated the bids properly, it did not pay adequate attention to the collective facts in the bids submitted in response to the RFP. In our view, consideration of the full set of facts should have raised a concern that the fairness and integrity of the bidding process had been compromised.

5.36 PWGSC officials believe that the government's contracting policy and the applicable law do not permit them to make such comparisons. PWGSC officials also believe that had such a comparison been made, any information obtained could not have been used to

alter the procurement process. In our view, while this policy and the law preclude the comparison of bids during the evaluation process, they do not, nor were they designed to, preclude the use of such comparisons for purposes that are unrelated to the evaluation of the bids, such as ensuring the integrity of the procurement process.

5.37 We noted that the variation between the two bids for property management services in the Canadian Forces contract was tens of millions of dollars. There were also significant differences among the three bids for property management services in the RCMP and Government of Canada contract.

5.38 In our view, these discrepancies should have been another warning sign for PWGSC to review the integrity of the information contained in the request for proposal and take necessary action to ensure fairness in the bidding process.

5.39 We noted that one individual had carried out the financial evaluation. In our view, this represents a control weakness in the evaluation process because it lacks an appropriate level of checks and balances. With more than one person involved in this process, it would be more likely that someone would identify and act upon signs that the process may have been compromised.

5.40 Recommendation. For significant and high-risk proposals, Public Works and Government Services Canada should ensure that more than one person evaluates the financial component of bids.

Public Works and Government Services Canada's response. Public Works and Government Services Canada agrees with this recommendation.

Additional actions could have been taken to address bidders' concerns

5.41 We reviewed the action that PWGSC took in response to questions from potential bidders on business volumes for property management services. PWGSC stated that it sought confirmation of the estimates contained in the request for proposal from the Treasury Board Secretariat, National Defence (Canadian Forces), and the RCMP and that they all confirmed that the business volumes stated in the RFP were correct. In our view, this action was not sufficient.

5.42 In developing the RFP for the contracts, the project authority, contract authority, or departmental authorities could have asked the incumbent service provider to provide statistics on actual business volumes. We found no evidence of such a request.

5.43 In addition, the project authority, contract authority, or departmental authorities could have analyzed the reasonableness of the business volumes contained in the RFP by developing volume estimates from the quarterly financial reports provided to them by Royal LePage Relocation Services. We found no evidence that such an analysis was carried out. The departments could also have requested their internal audit group to conduct a review to determine whether the business volumes set out in the RFP were reasonable.

5.44 We further expected that, based on questions from potential bidders, PWGSC would have reviewed and amended the RFP so that the proportion of Canadian Forces members who are homeowners (40 percent), rather than the proportion who are renters (60 percent), would be applied to property management services.

5.45 While the contracting policy and the applicable law prohibit the evaluation team from comparing competing bids during the evaluation process, we believe that PWGSC has to be alert to situations where the collective facts indicate that the fairness and integrity of the procurement process may have been compromised. Although PWGSC officials believe that the policy and the law prohibit them from comparing bids at all, we believe that consideration of all the available facts is necessary to ensure that the procurement process is fair. This is a fundamental accountability of PWGSC.

Information was inadequate for management's oversight of the evaluation of financial bids

5.46 In our review of the evaluation process, we assessed the nature and amount of briefing information provided to PWGSC managers who had overseen and reviewed the evaluation of the financial component of the bids.

5.47 We noted that PWGSC senior management received highly summarized information on the evaluation results from the contract officer to support the recommendation to award the contract. In our view, this information was not sufficiently detailed to allow management to effectively review and challenge the integrity of the evaluation.

5.48 **Recommendation.** When recommending a contract award for significant and high-risk proposals, Public Works and Government Services Canada contract officers should ensure that briefing material prepared for senior management contains sufficient detail to allow appropriate management oversight and review.

Public Works and Government Services Canada's response. Public Works and Government Services Canada agrees with this recommendation.

The technical evaluation was conducted according to government policy

5.49 An evaluation team made up of representatives from the Canadian Forces, RCMP, the Treasury Board Secretariat, and PWGSC conducted the technical evaluation of the contract bids. Team members were responsible for independently reviewing all bids to ensure that mandatory technical requirements were satisfied and for scoring sections of the evaluation criteria that were subject to a point-rating system.

5.50 After the scoring exercise, the team developed a final evaluation based on consensus. A fairness monitor who was present during those discussions confirmed that the technical evaluation was conducted in a fair and transparent manner.

5.51 We reviewed the technical evaluation of the bids to ensure that all bidders satisfied the mandatory requirements, and we examined the point-rated sections where either bidder lost points. In each section, we found a brief explanation of the bidder's deficiency and a rationale supporting the deduction of points.

5.52 We noted that in its May 2005 response to a complaint submitted by Envoy, the Canadian International Trade Tribunal stated that PWGSC bid evaluators inappropriately compared Envoy's proposal for the Canadian Forces contract and Envoy's two proposals for the RCMP and Government of Canada contract. The Tribunal recommended that a section of the proposals be re-evaluated by a new evaluation team and that each bidder's proposal be re-evaluated separately. If the re-evaluation resulted in a new winning bidder for either of the two contracts awarded, the existing contract should be cancelled and awarded to the newly successful bidder.

5.53 PWGSC appealed the Tribunal's decision to the Federal Court of Appeal. In January 2006, the Court upheld the Tribunal's finding that Envoy's bids had been inappropriately compared, but it struck down the Tribunal's recommendation to have PWGSC re-evaluate all bids. It was the Court's view that the re-evaluation of all bid proposals would have no effect on the 2004 award decision.

5.54 We concluded that, except for this issue of comparison of the bids, the evaluation of the technical portion of the bids was carried out in accordance with the Treasury Board Contracting Policy.

The rationale for the evaluation criteria was not documented

5.55 As part of our assessment of the process for awarding the contracts, we wanted to determine whether the basis for evaluating the bids had been established and communicated to potential bidders.

5.56 We expected that, as required by the Treasury Board Contracting Policy, the contract files would provide a complete audit trail containing details related to relevant communications and decisions, including the identification of officials and contracting approval authorities involved. In addition, the PWGSC Supply Manual states that a current file serves as a historical record and an accurate audit trail in the event of a financial review, subsequent legal action, or an official complaint. We expected that the file would include documentation of the rationale for evaluation criteria established.

5.57 We found that PWGSC had followed the Treasury Board Contracting Policy for establishing and disclosing the bid evaluation criteria and weighting system to be used. The request for proposal clearly indicated that a 75 percent weighting had been assigned to the evaluation of a bid's technical component and 25 percent to its financial component.

5.58 Although the RFP disclosed the evaluation criteria and the 75/25 split, the reasons why PWGSC chose this particular ratio were not documented in its procurement files. This is a concern because the evaluation criteria and the weighting of technical versus price considerations may influence the selection of the winning bid.

5.59 PWGSC officials told us that technical considerations had received a relatively heavy weighting because the primary objective of the Integrated Relocation Program was to ensure that the winner of the contract would deliver a high level of service. Quality-of-life considerations, therefore, took precedence over price. We found no documentation or analysis, however, to support this rationale for the weighting system.

5.60 PWGSC officials have also stated that this weighting was used to balance the concerns raised by potential bidders—that is, the incumbent's concern that its pricing structure was known to competitors and the new bidders' concern that a financial bid that had to take into account the cost of establishing the necessary infrastructure to deliver the program may result in their bid not being financially competitive.

The government may have paid too much for the Canadian Forces relocation contract

5.61 The technical components of the bid proposals of both Royal LePage Relocation Services and Envoy for the Canadian Forces contract complied with the terms and conditions of the request for proposal. The evaluation team evaluated the bid of RLRS at 984.20 and the bid of Envoy at 919.00 out of a possible 1,000 points.

5.62 We noted that when the amount bid for the administration fee to be charged for each relocation is combined with the amounts bid for the six third-party services, the aggregate amounts of the two bids were quite similar, with Envoy's bid being $9 million less. However, while the total amounts of the two bids were similar, we noted that the components of the amounts were substantially different.

5.63 Because PWGSC was unaware of the incorrect property management business volumes in the request for proposal, the government may have paid more than it needed to for the administrative services of a professional relocation company.

The government acted appropriately to preserve the integrity of the procurement process in cancelling the 2002 contract

5.64 The government awarded the first contract for the permanent Integrated Relocation Program to Royal LePage Relocation Services in December 2002. In March 2003, an unsuccessful bidder filed a complaint with the Canadian International Trade Tribunal alleging multiple deficiencies in the bid evaluation process. The Tribunal found the complaint partially valid.

5.65 At the same time, PWGSC was conducting an internal investigation into allegations of misconduct by its own employees. The investigation revealed that an employee of the Department was in a perceived conflict of interest. To address the perceived conflict of interest, PWGSC started a new procurement process; following the award of the contracts in 2004, it terminated the existing contract. Even though the government may incur additional costs as a result of terminating the 2002 contract for the Integrated Relocation Program, PWGSC acted appropriately to preserve the integrity of the government's procurement process.

Measuring the performance of the Integrated Relocation Program

Tools for measuring the program's performance have not been developed

5.66 As part of our audit, we examined the extent to which the Treasury Board Secretariat and the departments involved have an appropriate framework for measuring the effectiveness of the Integrated Relocation Program. Specifically, we expected that the framework would include clearly defined objectives and results to be achieved, and provisions to measure, evaluate, and report on key aspects, including the contractor's performance. Such a framework is essential to know if the program is providing good value for money and contributing to the quality of life of members and employees.

5.67 We expected to find mechanisms in place in the departments and at the Treasury Board Secretariat to measure and report on the financial and non-financial results of the Integrated Relocation Program and the performance of Royal LePage Relocation Services against clearly defined objectives and criteria.

5.68 For several years, the Treasury Board Secretariat and government departments have defined various objectives for the Integrated Relocation Program as it was being developed and implemented. These objectives focused on moving employees with a minimum of disruption and at reasonable cost. To this end, the program introduced ceiling rates that capped costs for a variety of services, such as real estate commissions. These cost control measures were to offset the expense of engaging a professional relocation company to administer the program.

5.69 We found that neither the departments nor the Treasury Board Secretariat had developed the tools or indicators needed to assess the performance of the program or the contractor in administering and delivering it.

Neither the Treasury Board Secretariat nor departments routinely assess the satisfaction among personnel who have been moved under the program

5.70 A key reason for implementing the Integrated Relocation Program was to improve the quality of life for members of the Canadian Forces and RCMP and other federal employees as they relocate. Given the number of moves an individual may make and the impact on their family, we expected that the Treasury Board Secretariat and departments would routinely measure this aspect of the program to ensure that this key objective was being met.

5.71 We found that the Secretariat and the departments rely mainly on a client satisfaction survey that Royal LePage Relocation Services

administers and presents to members and employees after they have moved. However, the survey collects information only on the services of RLRS and third-party suppliers. It does not solicit the opinions of members and employees on departmental policies and the relocation benefits their employers offer. Therefore, departments have little or no information on this important aspect of the program.

5.72 National Defence and Canadian Forces officials told us that there have been few grievances supported in favour of Canadian Forces members, indicating that the program is achieving one of its objectives of delivering fair and reasonable reimbursement of relocation expenses.

5.73 National Defence (Canadian Forces) acknowledged that its performance measurement system is not complete and that the Department is lacking feedback from members and not measuring the contractor's performance against stated objectives.

5.74 The RCMP indicated that its transferees frequently communicate their concerns about the Integrated Relocation Program and Royal LePage Relocation Services to departmental officials and that these concerns are addressed internally and with RLRS. However, the RCMP acknowledged that additional tools need to be developed to collect information from transferees in a more formal and systematic way. The Treasury Board Secretariat also addresses concerns raised by Government of Canada employees.

5.75 Although departments are addressing concerns and grievances related to relocation, they are not systematically tracking and analyzing them to identify systemic weaknesses or areas where the relocation policy may need to be revised.

5.76 Treasury Board Secretariat officials told us that a survey is being developed to collect information on the level of satisfaction with the program. It will be distributed before the end of 2006.

5.77 Recommendation. National Defence (Canadian Forces) and the RCMP should systematically collect information from members who have been relocated to measure their satisfaction with the benefits and incentives of the Integrated Relocation Program and the performance of the Royal LePage Relocation Services. This information should be used to guide any changes in policy.

National Defence's response. A comprehensive Performance Management Framework for the Canadian Forces Integrated Relocation Program will be developed and implemented. Feedback

from members will be one important element of this framework. As has been our practice, this feedback will be considered in the development of future policy amendments.

The RCMP's response. We agree. The RCMP will work in collaboration with the Treasury Board Secretariat and Public Works and Government Services Canada to develop tools by 15 April 2007 to measure members' satisfaction with the program and the performance of Royal LePage Relocation Services.

5.78 Recommendation. The Treasury Board Secretariat, as project authority, should establish mechanisms to systematically measure and report on the effectiveness of the Integrated Relocation Program.

The Treasury Board Secretariat's response. The Treasury Board Secretariat agrees with the recommendation. The Secretariat is re-establishing a survey tool (previously suspended in order to address contract re-tendering) to complement other mechanisms in place that assist in measuring performance. The Secretariat plans to launch the survey before the end of 2006. It should be noted that the Secretariat currently has mechanisms in place to monitor performance. The National Joint Council is used for identifying issues and difficulties that transferees may be encountering. The Secretariat also conducts outreach with departmental program coordinators to ensure that there is a solid community of practice to diminish risks and receive feedback on program effectiveness and applicability.

There is no system for monitoring the contractor's performance in delivering and administering the program

5.79 The Treasury Board Contracting Policy requires that departments and agencies involved in managing a contract for services clearly understand and carry out their roles and responsibilities for monitoring the performance of the contractor. The two contracts that we examined for the Integrated Relocation Program specify criteria or service standards against which to measure how well the contractor is performing. For example, the contracts stipulate that Royal LePage Relocation Services staff must return telephone calls within three business days. However, departments do not monitor or measure the performance of RLRS for this requirement.

5.80 We found that the Treasury Board Secretariat and departments have no formal process for tracking and monitoring problems, if any, related to the contractor's performance. Nor do they systematically analyze problems that do arise to find the causes and prevent them from recurring.

5.81 Recommendation. The Treasury Board Secretariat, National Defence (Canadian Forces), and the RCMP should establish formal mechanisms to measure and report on the contractor's performance.

The Treasury Board Secretariat's response. The Treasury Board Secretariat will work with Public Works and Government Services Canada, National Defence (Canadian Forces), and the RCMP to establish additional performance mechanisms to measure and report on the contractor's performance. To complement these proposed formal mechanisms, the Secretariat will continue to use other mechanisms already in place to monitor performance.

National Defence's response. As stated in our response to the recommendation at paragraph 5.77, a comprehensive Performance Management Framework will be developed and implemented by National Defence and the Canadian Forces. One aspect of this framework will be the establishment of objectives that will be used to measure and report on contractor performance.

The RCMP's response. We agree. The RCMP will work in collaboration with the Treasury Board Secretariat and Public Works and Government Services Canada to develop tools by 15 April 2007 to measure the performance of Royal LePage Relocation Services.

We found no data to show that outsourcing relocation services is cost-effective

5.82 The Treasury Board Secretariat told us that, since 1999, the pilot program and the permanent program have generated savings of almost 29 percent compared with pre-program costs. These savings are attributed to the use of ceiling rates for third-party services established by Royal LePage Relocation Services. Secretariat officials indicated that the savings from ceiling rates would offset the costs of obtaining the services of a professional relocation company; however, they were unable to provide documentation to support this claim. Moreover, National Defence (Canadian Forces), the largest program client, told us that no data is available that shows savings from outsourcing the relocation services.

5.83 In the absence of such data, we were unable to conclude whether the Integrated Relocation Program has generated sufficient savings to offset the cost of outsourcing the program to Royal LePage Relocation Services.

Controlling the spending of money

Financial controls for reimbursements to the contractor are inadequate

5.84 Complying with the terms of the *Financial Administration Act* and the Payments and Settlements Requisitioning Regulations is critical to the government's financial control process.

5.85 Under the terms of the Canadian Forces contract with Royal LePage Relocation Services, the company is responsible for paying third-party suppliers. The company also reimburses relocated personnel for costs such as hotels and meals. In 2005 these payments amounted to almost $180 million for the Canadian Forces.

5.86 Royal LePage Relocation Services pays these amounts from a zero balance account (see page 5) that it maintains for this purpose. The company informs National Defence (Canadian Forces) at the end of each day of the amount disbursed that day. Since 1 July 2006, National Defence has initiated all payments directly to the account in reimbursement on a daily basis. Before then, the Receiver General had the delegated authority to reimburse RLRS daily through the account. Payments of the "flow through" (non-administrative) costs are to be monitored by the Canadian Force's Directorate Compensation Benefits Administration. The administration fees of RLRS are submitted separately to the Canadian Forces for approval before payment is issued. These costs are not paid through the zero balance account.

5.87 Under this process, National Defence (Canadian Forces) issues payment before its staff can review the supporting documentation to ensure that payments have been made to valid parties and that they are consistent with the policies on relocation.

5.88 While the Treasury Board Account Verification Policy allows a department to do the necessary verification work required under section 34 of the *Financial Administration Act* after—rather than before—goods or services are paid for, adequate control requires that the accounts be verified within a reasonable period of time.

5.89 We noted that National Defence (Canadian Forces) has not been completing the necessary review and verification work. The Department has not been carrying out sufficient pre- or post-payment verification work since the launch of the Integrated Relocation Program in 1999. Currently, a backlog of about 36,250 account files need to be reconciled.

5.90 The Department indicated that since 1999 it has not had enough resources to deal with the problem or to carry out a number of

related tasks. These include determining audit requirements and program evaluation criteria, carrying out audits, determining and recovering amounts owed to the government, and performing adequate pre-payment validation under section 34 of the *Financial Administration Act*.

5.91 The Department has begun to develop the systems and processes needed to comply with sections 34 and 33 of the Act as part of a larger management control framework. It is not clear when this work will be completed.

5.92 The RCMP also has a financial control problem. As previously mentioned, the RCMP does not operate a zero balance account but makes a series of advances to Royal LePage Relocation Services based on estimates of a move's final costs. However, when actual documentation is finally received, it uses only a limited, informal, risk-based audit approach to verify relocation expenses. In our view, this approach is insufficient before final settlement with the contractor. Departmental officials in the Pacific Region told us that they lack the resources needed to perform proper audits of closed files.

5.93 Recommendation. National Defence (Canadian Forces) should take steps to comply with the *Financial Administration Act* and to develop a plan to ensure that expenditures made under the Integrated Relocation Program are valid and accurate.

National Defence's response. National Defence and the Canadian Forces are currently implementing an exception reporting approach to certifying transactions under section 34 of the *Financial Administration Act*. At the same time, we are pursuing a more comprehensive solution that will require an additional investment in personnel as well as enhanced information management and information technology support.

5.94 Recommendation. National Defence (Canadian Forces) should analyze a sample of Integrated Relocation Program transactions from previous years to assess the risk that amounts spent on the program do not comply with the policy or contractual terms and conditions. If amounts identified are significant, the extent of testing should be increased. If necessary, National Defence (Canadian Forces) should develop a strategy to recover funds.

National Defence's response. National Defence and the Canadian Forces will be reviewing a number of Integrated Relocation Program files from prior years to assess the extent to which payments complied with policy and members received their respective entitlements.

5.95 Recommendation. The RCMP should ensure that it complies more rigorously with account verification policies and procedures for validating expenditures for the Integrated Relocation Program.

The RCMP's response. We agree. The RCMP will create a standardized procedural guide to assist RCMP relocation reviewers to reconcile Integrated Relocation Program files in a consistent and formal manner, by 15 April 2007, in accordance with the government's account verification policies and procedures.

Fees charged for property management services are higher than contracted rates

5.96 As part of our audit, we reviewed a sample of 10 relocations involving the use of property management services to determine if amounts charged to members were in accordance with the ceiling rate set out in the contract (Exhibit 5.4). The Canadian Forces contract establishes a ceiling rate of zero percent ($0), which is the maximum rate that transferees should pay for property management services if they choose not to sell their home during the relocation process.

Exhibit 5.4 Canadian Forces contract—ceiling rate requirement

Section 11.2 of the Canadian Forces contract for the Integrated Relocation Program states:

"The requirements of the Statement of work [which includes property management services] shall be completed in accordance with the terms and conditions of the Contract and shall be subject to the ceiling prices specified."

Annex 'B'1(b) of the Canadian Forces contract states:

"The Contractor will be reimbursed for [third party service] fees at actual cost up to the ceiling rate quoted with no allowance for profit or overhead."

5.97 We found that all 10 Canadian Forces members had paid an amount for property management services, from their own funds, that exceeded the contractual rate by between $800 and just over $8,000.

5.98 Recommendation. National Defence (Canadian Forces) should complete a review of all relocations involving property management services to determine the full extent of overpayment and ensure that Canadian Forces members are reimbursed for property management services paid in excess of contractual rates.

National Defence's response. National Defence and the Canadian Forces will conduct a complete review and legal analysis of property management fees and expenditures. Once this review and analysis is complete, payments to members will be adjusted accordingly.

5.99 Recommendation. Public Works and Government Services Canada should ensure that all ceiling rates are in accordance with the terms and conditions of the contract.

Public Works and Government Services Canada's response. Public Works and Government Services Canada agrees with this recommendation and will conduct a detailed investigation to ensure that all ceiling rates are in accordance with the terms and conditions of the contract. Any overpayment will be reimbursed to the Crown in accordance with the audit provisions of the contracts.

Conclusion

5.100 A basic principle of government procurement is that bidders can rely on the completeness, accuracy, and integrity of the information in the request for proposal and that bids will be evaluated fairly and equitably.

5.101 We have concluded for two reasons that the Canadian Forces and RCMP/Government of Canada contracts were not tendered in a fair and equitable manner. First, some of the business volumes incorporated into the request for proposal by the Treasury Board Secretariat, National Defence (Canadian Forces), and the RCMP contained materially incorrect information.

5.102 Second, although PWGSC followed its established processes, these steps were not sufficient—particularly when concerns had been raised—to offset an unfair advantage the incumbent bidder had attained through its work on a previous contract and to ensure that all bidders in the tendering process had access to correct and complete information.

5.103 The Integrated Relocation Program was launched to improve the quality of service provided to members of the Canadian Forces and RCMP and other federal employees who are relocated. Despite the focus on the quality of life as a main reason for the program, we found that neither the Treasury Board Secretariat nor the departments have developed performance measures to demonstrate whether the program's objectives are being met.

5.104 National Defence has yet to establish basic internal controls for the expenditure of public funds for the program, and the RCMP needs to ensure that it complies more rigorously with the government's policies and procedures for validating expenditures for the Integrated Relocation Program.

5.105 Members of the Canadian Forces have been charged amounts for property management services in excess of rates established in the contract.

About the Audit

Objectives

The objectives of this audit were to determine whether

- the contracts for the Integrated Relocation Program were awarded according to the Treasury Board Contracting Policy, government contracting regulations, and the Public Works and Government Services Canada (PWGSC) Supply Manual;
- the contracts were managed and administered according to the terms and conditions of government and departmental relocation policies; and
- the Treasury Board Secretariat and the departments involved established performance measures to demonstrate and report that objectives of the program are being met.

Scope and approach

Departments and agencies included in the audit were

- the Treasury Board Secretariat (project authority);
- Public Works and Government Services Canada (contract authority);
- National Defence (Canadian Forces); and
- the Royal Canadian Mounted Police.

While this chapter includes the names of various contractors, it must be noted that our conclusions about management practices and actions refer only to those of public servants. The rules and regulations we refer to are those that apply to public servants; they do not apply to contractors. We did not audit the records of the private sector contractors. Consequently, our conclusions cannot and do not pertain to any practices that contractors followed. We did not assess individual expenses claims made by relocated employees or activities related to the moving of household goods.

Criteria

We conducted the audit using the following criteria:

- The contracting process for the Integrated Relocation Program was conducted according to the Treasury Board Contracting Policy, government contracting regulations, and the PWGSC Supply Manual.
- The contracts for the program were administered according to the terms and conditions of government and departmental relocation policies.
- The financial administration of the contracts and program complied with the *Financial Administration Act*, Account Verification Policy, and other relevant financial management policies of the Treasury Board.

We expected that the Treasury Board Secretariat and departments would have established performance measures that would include the following:

- clearly defined objectives and results that are to be achieved by the Integrated Relocation Program;
- an information framework that measures, evaluates, and reports on key aspects of the program;
- a procedure for the receipt of timely program performance information; and
- use of the performance information gathered to improve the efficiency and effectiveness of the program.

Audit work completed

Audit work for this chapter was substantially completed on 23 August 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 5. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Organizations' responses
Contracting for the Integrated Relocation Program	
5.40 For significant and high-risk proposals, Public Works and Government Services Canada should ensure that more than one person evaluates the financial component of bids. **(5.34–5.39)**	**Public Works and Government Services Canada's response.** Public Works and Government Services Canada agrees with this recommendation.
5.48 When recommending a contract award for significant and high-risk proposals, Public Works and Government Services Canada contract officers should ensure that briefing material prepared for senior management contains sufficient detail to allow appropriate management oversight and review. **(5.46–5.47)**	**Public Works and Government Services Canada's response.** Public Works and Government Services Canada agrees with this recommendation.
Measuring the performance of the Integrated Relocation Program	
5.77 National Defence (Canadian Forces) and the RCMP should systematically collect information from members who have been relocated to measure their satisfaction with the benefits and incentives of the Integrated Relocation Program and the performance of the Royal LePage Relocation Services. This information should be used to guide any changes in policy. **(5.70–5.76)**	**National Defence's response.** A comprehensive Performance Management Framework for the Canadian Forces Integrated Relocation Program will be developed and implemented. Feedback from members will be one important element of this framework. As has been our practice, this feedback will be considered in the development of future policy amendments. **The RCMP's response.** We agree. The RCMP will work in collaboration with the Treasury Board Secretariat and Public Works and Government Services Canada to develop tools by 15 April 2007 to measure members' satisfaction with the program and the performance of Royal LePage Relocation Services.

Recommendation	Organizations' responses
5.78 The Treasury Board Secretariat, as project authority, should establish mechanisms to systematically measure and report on the effectiveness of the Integrated Relocation Program. (5.70–5.76)	**The Treasury Board Secretariat's response.** The Treasury Board Secretariat agrees with the recommendation. The Secretariat is re-establishing a survey tool (previously suspended in order to address contract re-tendering) to complement other mechanisms in place that assist in measuring performance. The Secretariat plans to launch the survey before the end of 2006. It should be noted that the Secretariat currently has mechanisms in place to monitor performance. The National Joint Council is used for identifying issues and difficulties that transferees may be encountering. The Secretariat also conducts outreach with departmental program coordinators to ensure that there is a solid community of practice to diminish risks and receive feedback on program effectiveness and applicability.
5.81 The Treasury Board Secretariat, National Defence (Canadian Forces), and the RCMP should establish formal mechanisms to measure and report on the contractor's performance. (5.79–5.80)	**The Treasury Board Secretariat's response.** The Treasury Board Secretariat will work with Public Works and Government Services Canada, National Defence (Canadian Forces), and the RCMP to establish additional performance mechanisms to measure and report on the contractor's performance. To complement these proposed formal mechanisms, the Secretariat will continue to use other mechanisms already in place to monitor performance. **National Defence's response.** As stated in our response to the recommendation at paragraph 5.77, a comprehensive Performance Management Framework will be developed and implemented by National Defence and the Canadian Forces. One aspect of this framework will be the establishment of objectives that will be used to measure and report on contractor performance. **The RCMP's response.** We agree. The RCMP will work in collaboration with the Treasury Board Secretariat and Public Works and Government Services Canada to develop tools by 15 April 2007 to measure the performance of Royal LePage Relocation Services.

Recommendation	Organizations' responses
Controlling the spending of money	
5.93 National Defence (Canadian Forces) should take steps to comply with the *Financial Administration Act* and to develop a plan to ensure that expenditures made under the Integrated Relocation Program are valid and accurate. (5.84–5.92)	**National Defence's response.** National Defence and the Canadian Forces are currently implementing an exception reporting approach to certifying transactions under section 34 of the *Financial Administration Act*. At the same time, we are pursuing a more comprehensive solution that will require an additional investment in personnel as well as enhanced information management and information technology support.
5.94 National Defence (Canadian Forces) should analyze a sample of Integrated Relocation Program transactions from previous years to assess the risk that amounts spent on the program do not comply with the policy or contractual terms and conditions. If amounts identified are significant, the extent of testing should be increased. If necessary, National Defence (Canadian Forces) should develop a strategy to recover funds. (5.84–5.92)	**National Defence's response.** National Defence and the Canadian Forces will be reviewing a number of Integrated Relocation Program files from prior years to assess the extent to which payments complied with policy and members received their respective entitlements.
5.95 The RCMP should ensure that it complies more rigorously with account verification policies and procedures for validating expenditures for the Integrated Relocation Program. (5.84–5.92)	**The RCMP's response.** We agree. The RCMP will create a standardized procedural guide to assist RCMP relocation reviewers to reconcile Integrated Relocation Program files in a consistent and formal manner, by 15 April 2007, in accordance with the government's account verification policies and procedures.
5.98 National Defence (Canadian Forces) should complete a review of all relocations involving property management services to determine the full extent of overpayment and ensure that Canadian Forces members are reimbursed for property management services paid in excess of contractual rates. (5.96–5.97)	**National Defence's response.** National Defence and the Canadian Forces will conduct a complete review and legal analysis of property management fees and expenditures. Once this review and analysis is complete, payments to members will be adjusted accordingly.

Recommendation	Department's response
5.99 Public Works and Government Services Canada should ensure that all ceiling rates are in accordance with the terms and conditions of the contract. **(5.96–5.97)**	**Public Works and Government Services Canada's response.** Public Works and Government Services Canada agrees with this recommendation and will conduct a detailed investigation to ensure that all ceiling rates are in accordance with the terms and conditions of the contract. Any overpayment will be reimbursed to the Crown in accordance with the audit provisions of the contracts.

Report of the Auditor General of Canada to the House of Commons—November 2006

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Report of the Auditor General of Canada to the House of Commons

NOVEMBER

Chapter 6
Old Age Security—Human Resources and Social Development Canada and Service Canada

Office of the Auditor General of Canada



2006



Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Chapter 6

Old Age Security—Human Resources and Social Development Canada and Service Canada

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.



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Ce document est également publié en français.

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Cat. No. FA1-2006/1-6E
ISBN 0-662-44370-5

Chapter

6

Old Age Security

Human Resources and Social Development Canada and Service Canada

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Old Age Security

Human Resources and Social Development Canada and Service Canada

Main Points

What we examined

The Old Age Security program pays three benefits to seniors, each with its own eligibility conditions—the Old Age Security (OAS) pension, the Guaranteed Income Supplement (GIS), and the Allowance. Human Resources and Social Development Canada and Service Canada manage the program. We examined whether these organizations provide adequate access to program benefits, have reasonable assurance that correct benefits are paid to eligible beneficiaries, and record and collect overpayments in accordance with legislation and policy.

The reporting of the audit, originally scheduled for April 2006, was deferred because of changes to the parliamentary calendar as a result of the federal election. To update our observations, in August 2006 we obtained information from both organizations on any action they may have taken to address the observations and recommendations in this chapter. We have provided that information under **Subsequent events**.

Why it's important

The Old Age Security program provides a basic income for its beneficiaries, many of whom have little other income. The number of beneficiaries is expected to double in the next 25 years. It is important that the program be managed in such a way that everyone who is entitled to benefits is able to apply for and receive them.

More than 4 million people receive OAS benefits amounting to a total of about $28 billion each year—14 percent of the federal government's total yearly spending. With so many current beneficiaries and still more to come in the future, errors that affect even a small proportion of clients or payments can involve relatively large numbers of individuals or large amounts of money. To demonstrate good stewardship of public funds, those who deliver the program need to understand and manage the risks involved.

What we found

- Human Resources and Social Development Canada and Service Canada have improved seniors' access to program benefits by simplifying the application process and by implementing initiatives to

increase the take-up of GIS. However, the organizations lack adequate information on these and other aspects of their service to clients, and do not give Parliament a complete picture of program performance.

- Quality reviews by Service Canada staff in processing centres, as well as our own testing, suggest that errors in establishing monthly payment amounts at the time of application occur at relatively low rates. However, because payment accuracy is not measured systematically, there is no assurance that this will be sustained. Moreover, the quality of application processing is not monitored adequately, and quality deficiencies occur at significantly varying rates from one quality review to another. Quality deficiencies—failures to follow processing policies and procedures—can lead to payment errors. Practices for updating accounts and assessing continuing eligibility are also not consistent from one processing centre to another.
- Human Resources and Social Development Canada and Service Canada do not have the consolidated information they need to properly manage overpayments. They lack a consistent approach to collecting overpayments across all processing centres. Further, the two organizations do not charge interest on OAS overpayments, despite a legislative requirement to do so.
- Information provided in August 2006 by Human Resources and Social Development Canada and Service Canada indicates that they have begun action to strengthen their management of the OAS program. They indicated that, by the end of 2007, they will have collected and reported improved information on client satisfaction and services, implemented a national quality review system, and improved information on overpayments. They also plan to issue a revised policy on managing overpayments.

Human Resources and Social Development Canada and Service Canada have responded. Human Resources and Social Development Canada and Service Canada have agreed with each of our recommendations and have committed to take action. Their responses are included throughout the chapter.

Introduction

The Old Age Security program provides income support to seniors

6.1 The Old Age Security (OAS) program provides income support to Canadian seniors. It dates back to 1952, when Parliament passed the *Old Age Security Act*. The program pays benefits monthly, with quarterly adjustments for increases in the cost of living.

6.2 The OAS program pays three benefits:

- the OAS pension;
- the Guaranteed Income Supplement (GIS); and
- the Allowance, including Allowance for the Survivor.

6.3 There are eligibility conditions for each benefit, and the amounts to which beneficiaries are entitled depend on their age, residence history, income, and marital status (Exhibit 6.1). In general, in January 2006

- a single beneficiary over the age of 65 with an income greater than $15,000 could receive a maximum of $484.63 in OAS pension benefits per month;
- a single beneficiary over the age of 65 with an income less than $15,000 could receive a maximum of $1,078.60 in OAS pension and GIS benefits per month;
- each member of a married couple with a combined income less than $19,000 could receive a maximum of $874.30 in OAS and GIS or Allowance benefits per month; and
- a surviving spouse or common-law partner between 60 and 64 years of age, with an income less than $20,000, could receive a maximum of $967.24 in Allowance for the Survivor benefits per month.

Federal organizations delivering the program are in transition

6.4 Human Resources Development Canada delivered the OAS program until 12 December 2003, when the government announced the division of this department into two new departments: Social Development Canada and Human Resources and Skills Development Canada. Social Development Canada's mandate was to design and deliver a range of social programs, including the Old Age Security program.

Exhibit 6.1 Old Age Security (OAS) benefits and who can receive them

Benefit	Eligibility conditions	Maximum monthly payment (January 2006)	Key features
OAS pension	The pension is designed to provide modest retirement income for seniors. The benefit is available to Canadian citizens and legal residents who • are 65 years of age or over; • have resided in Canada for a minimum of 10 years (20 years if applying from abroad) after reaching age 18; and • applied for the benefit.	$484.63	The pension is paid as a full or partial benefit, depending on length of residence in Canada (Exhibit 6.3). The benefit may be paid retroactively for a period of up to 11 months (plus the month the application is received) provided all conditions of eligibility are met. An individual who has resided in Canada for less than 10 years but who lived in a country having a social security agreement with Canada may qualify for a partial pension. In 2006, a pensioner with a total income greater than $62,144 must repay part or all of the benefit through the tax system.
Guaranteed Income Supplement (GIS)	The GIS is an additional benefit available to low-income OAS recipients. Yearly income (excluding OAS pension) may not exceed certain limits. If the applicant is married or living in a common-law relationship, the combined income of the pensioner and spouse or common-law partner is taken into account. The OAS recipient must apply separately for the GIS benefit.	Single person: $593.97 Spouse or common-law partner of • a non-pensioner: $593.97 • a pensioner: $389.67 • an Allowance recipient: $389.67	The GIS may increase or decrease according to reported changes in a recipient's yearly income and marital status. If a pensioner or that person's spouse or common-law partner has retired or has a loss of pension income, the application may include an income estimate for the current calendar year in place of the income of the preceding calendar year. The GIS is not taxable. Recipients must re-apply annually for the benefit, or file a tax return.
Allowance, including Allowance for the Survivor	The Allowance is paid to the spouse or common-law partner of someone receiving the OAS pension and the GIS. The Allowance for the Survivor is paid to someone whose spouse or common-law partner has died. Combined yearly income (excluding OAS or GIS) of the couple, or the annual income of the survivor, may not exceed certain limits. At the time of application, the spouse (or common-law partner) or survivor must • be between 60 and 64, • have resided in Canada for at least 10 years after age 18, and • be a legal resident in Canada.	Spouse: $874.30 Survivor: $967.24	The Allowance may increase or decrease according to reported changes in a recipient's yearly income. If a pensioner or that person's spouse or common-law partner has retired or has a loss of pension income, the application may include an income estimate for the current calendar year in place of the income of the preceding calendar year. The Allowance ceases at age 65. The Allowance also ceases if the spouse or common-law partner receiving a pension ceases to be eligible for the GIS, or if the spouses or common-law partners divorce or separate for more than 3 months. In addition, the Allowance for the Survivor ceases if the survivor remarries or lives in a common-law partnership for more than 12 months. The Allowance is not taxable. Recipients must re-apply annually for the benefit or file a tax return.

Source: Human Resources and Social Development Canada

6.5 In May 2005 the Treasury Board approved the creation of Service Canada. The organization describes its goal as to "provide Canadians with one-stop, easy-to-access, personalized service," including delivery of OAS program benefits. Service Canada delivers services to OAS program beneficiaries through its processing centres and call centres, as well as service centres located across Canada.

6.6 Social Development Canada remained responsible for the OAS legislation and for policy development and design of the OAS program. In February 2006 Social Development Canada was merged with Human Resources and Skills Development Canada to form Human Resources and Social Development Canada. Service Canada, though not a separate legal entity, continued to operate autonomously.

6.7 In the transition to these new arrangements, the challenge was to maintain client service without disruption while implementing a new client service approach. Officials told us that these major reorganization efforts had an impact on program-related work, such as the further development of performance measures.

Large and growing payments are being made to a large and growing number of recipients

6.8 More than 4 million people receive OAS program benefits. Net expenditures totalled $27.9 billion in 2004–05 (Exhibit 6.2).

6.9 In the coming decades, the number of OAS beneficiaries will increase. The Chief Actuary of Canada estimates that the number of people receiving OAS pensions will more than double from 2004 to 2030. Growth is expected to be slower in the number of GIS beneficiaries, who have little or no other income, but they will still account for more than one quarter of program beneficiaries by 2030.

Exhibit 6.2 Old Age Security (OAS) expenditures and beneficiaries, 2004–05

OAS program benefit	Expenditures ($ millions)	Number of beneficiaries
OAS pension	21,364*	4,098,785
Guaranteed Income Supplement	6,038	1,484,834
Allowance	469	93,748

* This amount does not include a $745-million "clawback" collected by the Canada Revenue Agency from high-income beneficiaries. For 2006, OAS pension benefits are reduced on a sliding scale for beneficiaries with incomes over $62,144 and are fully clawed back on incomes over $100,914.

Source: Human Resources and Social Development Canada

6.10 With so many beneficiaries and still more to come in the future, problems that concern a small proportion of clients or payments can affect relatively large numbers of individuals or involve relatively large amounts of money. It is important that the program be managed in such a way that everyone who is entitled to benefits is able to apply for and receive them. At the same time, it is essential for Human Resources and Social Development Canada and Service Canada to ensure the accuracy of OAS program payments.

Focus of the audit

6.11 Our audit objectives were to determine whether

- Human Resources and Social Development Canada and Service Canada make information about the Old Age Security program available and provide access to services in ways that respond to beneficiaries' needs;
- the systems and practices for determining initial benefit eligibility and for monitoring continuing eligibility provide reasonable assurance that eligible individuals receive the correct Old Age Security program benefits; and
- overpayments of Old Age Security program benefits are identified, collected, or forgiven in accordance with applicable legislation and policies.

6.12 Our audit focused on the systems and practices used by Human Resources and Social Development Canada and Service Canada for making program benefits accessible, verifying initial and continuing eligibility, and dealing with overpayments. We examined practices at the national headquarters of both organizations and in 4 of their 10 regions. In each region we visited some service centres, we held discussions with officials from the regional headquarters, and we visited a processing centre where staff assess OAS applications and make other changes to beneficiaries' accounts.

6.13 We conducted audit tests on benefit application and overpayment data provided by Human Resources and Social Development Canada. We did not audit the data for completeness. However, after analysis, comparison, file review, and discussion, we were sufficiently assured that we could rely on the data for our tests.

6.14 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Accessing program benefits

Initiatives are increasing the number of seniors receiving benefits

6.15 Human Resources and Social Development Canada knows that not all seniors eligible for Old Age Security program benefits receive them. Of particular concern are seniors with little or no other income who may be eligible for the Guaranteed Income Supplement but do not receive it; in other words, they do not "take-up" their eligibility for the program. In 2001 the House of Commons Standing Committee on Human Resources Development and the Status of Persons With Disabilities released a report on the issue, entitled *The Guaranteed Income Supplement: The Duty to Reach All.*

6.16 To increase the number of seniors receiving OAS program benefits, Human Resources and Social Development Canada and Service Canada have undertaken three main activities:

- **GIS automatic renewal.** Because a beneficiary's annual income determines eligibility, the GIS must be renewed yearly. Since 2000 it has been renewed automatically for most beneficiaries when they file their income tax return each year with the Canada Revenue Agency. Currently, this is how the GIS is renewed for 86 percent of beneficiaries; for most of the remaining 14 percent, it cannot be renewed automatically because they did not file an income tax return. Renewal applications are sent to those beneficiaries.
- **GIS mailings.** Since February 2002, Human Resources and Social Development Canada has mailed pre-filled GIS application forms yearly to about 100,000 seniors identified from Canada Revenue Agency data as having low incomes and possibly being eligible for the Supplement.
- **Outreach.** Human Resources and Social Development Canada has staff in each region whose primary responsibility is to reach out to seniors, provide them with information, and encourage and help them to apply for benefits. In response to a 2001 evaluation of its outreach program, the Department changed its approach from providing individuals with information to striving to reach more vulnerable population groups and working in partnership with community organizations involved with seniors.

6.17 Human Resources and Social Development Canada has used tax data from Statistics Canada to estimate the number of eligible tax filers who are not receiving the GIS. Tax returns do not collect certain information needed to determine eligibility, such as beneficiaries'

residence history; consequently, the Statistics Canada figures overestimate the number of GIS non-recipients who might be eligible. Partly as a result of this, only between 41 and 71 percent of seniors who receive the pre-filled applications each year apply for benefits. Nevertheless, the number of seniors receiving benefits increased significantly from 2001 to 2002, reducing the number of potentially eligible non-recipients from about 195,000 to 135,000. The increase coincided with the start of the GIS mailings and the changes made to the outreach program.

6.18 Human Resources and Social Development Canada and Service Canada have limited information on why potentially eligible seniors do not apply for the GIS. The two organizations also lack data collection mechanisms that would reveal whether outreach activities translate into applications received. However, Human Resources and Social Development Canada plans to conduct a program evaluation of GIS take-up in 2006–07 and another evaluation of the outreach program in 2008–09. The evaluations may yield better information about whether current take-up initiatives are targeted appropriately and are as effective as they could be.

The application process for beneficiaries has been simplified

6.19 In 2000–01 Human Resources and Social Development Canada (then Human Resources Development Canada) analyzed the process and documentation required to apply for OAS program benefits. The aim was to identify opportunities for simplification. In response to the resulting recommendations, the Department has made many simplifications and is considering others.

6.20 We reviewed the simplified application forms for OAS program benefits to determine whether they asked for the same information as other income security programs managed by Human Resources and Social Development Canada and Service Canada, and whether all the requested information was needed to determine eligibility. For the most part, the two organizations only asked for information they did not already have. Officials told us that they are examining the few remaining instances of duplication to identify further opportunities for simplification.

Assessing program risks

Eligibility rules are often complex

6.21 For about 60 percent of OAS benefit applicants—seniors who were born in Canada, have lived here all their lives, and are not applying for the GIS—determining eligibility is straightforward. These

applicants qualify for the full OAS pension. They are entitled to continue receiving their benefit if they choose to live outside Canada, although they must provide Service Canada with up-to-date contact information. There is nonetheless a need for vigilance and appropriate controls to protect against error or fraud.

6.22 The eligibility rules are more complicated for the other 40 percent of OAS benefit applicants. The residence and portability rules are particularly complex (Exhibit 6.3).

6.23 Information from benefit applicants must be assessed against these and the program's other eligibility conditions. Errors may occur and inaccurate payments may be issued if service delivery agents make mistakes in processing the information, or if beneficiaries or their representatives make mistakes in supplying the information or fail to promptly report changes in their circumstances.

Assessment of risks to payment accuracy has begun

Payment accuracy—The right person receives the right benefit at the right time, and for the intended purpose.

6.24 To manage the complexity of the program rules and protect against error and fraud, Human Resources and Social Development Canada and Service Canada first need a good understanding of the risks they face. The two organizations recognize the importance of risk assessment for effective management. They have periodically conducted risk assessment exercises at various levels of management responsible for the OAS program, both at national headquarters and in the regions we visited.

6.25 As a result, even though the OAS program itself has not undergone a structured and comprehensive risk assessment, Service Canada has identified the following areas as requiring greater attention to eliminate or reduce the risk of error and fraud:

- identity fraud,
- incorrect residence information,
- incorrect marital status information,
- incorrect information about annual income, and
- late notification of death of a beneficiary.

6.26 At the time we completed our audit fieldwork in October 2005, the risks were still in the early stages of being assessed; this involved determining on a program-wide basis how often information about beneficiaries' circumstances was not correct or up to date, and identifying the impact in terms of inaccurate payments. Recent

assessments have often been responses to particular incidents or proposals to change procedures. The result is that assessment of several of the risks was partial or not yet completed.

Exhibit 6.3 Residence and portability rules for Old Age Security (OAS) benefits

Eligibility requirement	Benefit affected	Rules
Residence	OAS pension	The amount of pension paid depends on the rule under which the beneficiary qualifies. **Full pension—40-year rule** The applicant has resided in Canada for at least 40 years after age 18 and before approval of the application. **Full pension—10-year rule** On 1 July 1977, the applicant was 25 years or older, and • was living in Canada, or • had already lived in Canada after age 18, or • possessed a valid Canadian immigration visa, and has resided in Canada for the last 10 years immediately before the date of approval of the application. **Full pension—"3 for 1" rule** On 1 July 1977, the applicant was 25 years or older, and • was living in Canada, or • had already lived in Canada after age 18, or • possessed a valid Canadian immigration visa, and has resided in Canada for at least 1 year immediately before the date of approval of the application, and was present in Canada after age 18 and before the 10 years immediately preceding the date of approval of the application, for periods totalling at least three times the length of absences during the 10-year period. **Partial pension** The applicant has resided in Canada for at least 10 years but less than 40 years after age 18. • 1/40 of the full pension is granted for each full year of residence in Canada. • The amount of the partial pension does not change once it has been approved, even if the recipient continues to reside in Canada.
	GIS and Allowances	The applicant must have resided in Canada for at least 10 years.
Portability (benefit can continue to be paid indefinitely to a recipient living outside Canada)	OAS pension	The applicant must have resided in Canada for at least 20 years before departure. In the case of a partial pension, the 20 years may include time resided in Canada after approval of the pension. If the applicant has resided in Canada for less than 20 years, payments are stopped after six months following the month of departure from the country.
	GIS and Allowances	The applicant must live in Canada to receive benefits. Payments are stopped after six months following the month of departure from Canada.

Source: *Old Age Security Act*

Risk management is being strengthened

6.27 Service Canada was developing a national risk management plan at the time of the audit. It was assessing current data available and the potential for using it to identify risks and indicators of higher risk. Officials told us that they expect the work to lead to the implementation of a new, ongoing risk management approach beginning in July 2006.

Determining benefits

The quality of application processing is not adequately monitored

6.28 **National quality review.** At the time of the audit, Human Resources and Social Development Canada and Service Canada did not have a nationally standardized **quality review** procedure for applications for OAS program benefits. As a result, there was no current, program-wide information on the quality or accuracy of application processing.

Quality review—Check by a second person, often on a sample basis, of a service delivery agent's processing action to confirm that all policies and procedures have been followed.

6.29 We therefore conducted a test of the quality of processing on a representative national sample of 400 applications for OAS program benefits that were processed from April to June 2005.

6.30 The most common quality deficiencies were

- lack of evidence on file to indicate whether certain types of income had been verified,
- processing of applications with inadequate supporting documentation or with no evidence on file to indicate whether adequate supporting documentation had been reviewed, and
- failure to properly approve applications.

Quality deficiency—Failure to follow processing policies and procedures, potentially leading to a payment error.

Payment error—Failure to issue funds to the right beneficiary, or for the right benefit, or in the right amount, or at the right time.

6.31 **Quality deficiencies** may or may not cause a **payment error**. This is because the potential for a payment error depends not only on the actions of the service delivery agent, but also on the accuracy of the information provided by the applicant and on the applicant's circumstances. For example, if the service delivery agent did not verify certain income information in an application, this omission could cause a payment error only if the information provided was in fact incorrect.

6.32 We found quality deficiencies in 9 percent of the applications we reviewed. The two organizations followed up on the quality deficiencies we identified to see whether payment errors had resulted. They confirmed payment errors in less than 1 percent of applications. These errors involved 0.6 percent of the total amount of monthly benefits to which applicants in the sampled period were entitled.

6.33 In reviewing how the applications were processed, we found that some prescribed procedures for handling applications appeared to be unnecessary, inconsistent, or not sufficiently clear. We also found weaknesses in the way that applicants' documentation was managed, which made it difficult to locate some information in a timely manner. As a result, officials told us that they would be examining their processing and document management procedures to determine how they could be streamlined or clarified.

6.34 **Quality reviews in processing centres.** Each of the processing centres we visited had conducted some quality reviews during the previous three years, although the extent of the reviews varied substantially.

6.35 Of the processing centres we visited, one had a more comprehensive system than the others. In each of the previous three years it had conducted reviews of all types of applications and of some actions to update beneficiaries' accounts. The processing centre had detailed instructions on how to review files and classify errors; it produced regular, detailed reports to management; and it had established targets for processing accuracy.

6.36 Two other processing centres had conducted some reviews but not annually. The reviews did not cover all types of applications, and regular reports on results were not provided to management. The fourth processing centre provided individual feedback to service delivery agents whose work was reviewed, but it did not consolidate the results to provide information to management.

6.37 In the three processing centres that had documented the results of their quality reviews, we found 13 reports of quality reviews. We did not audit the conduct of the reviews. We noted that the reviews reported rates of quality deficiencies ranging from 0 to 40 percent of cases. They also showed that the deficiencies had led to payment errors in 0 to 7 percent of cases.

6.38 While our test of the quality of application processing suggests that payment error rates are low, the rates reported in quality reviews in processing centres show an important variation. Also varying substantially are the rates of quality deficiency, which may lead to payment errors. The variation in error rates signals a need for systematic monitoring of the quality of application processing to ensure that payment error rates remain controlled.

6.39 **Recommendation.** Service Canada should implement a nationally standardized quality review system for applications for OAS

program benefits, covering all types of applications and other key processing activities.

Service Canada's response. With the introduction of Service Canada enterprise-wide approaches, work is under way to conduct a baseline assessment of quality review processes. In 2006–07 a national quality review program will be introduced.

6.40 Recommendation. Until a standardized approach is in place, Service Canada should direct its processing centres to apply existing quality review procedures more systematically.

Service Canada's response. The national quality review system to be implemented in 2006–07 will include standardized procedures for use by regional processing centres.

Service Canada is reviewing reports on updating and correcting accounts

6.41 Each month the OAS information system automatically generates reports that identify actions needed on beneficiaries' accounts and possible problems in the processing actions undertaken by service delivery agents. The reports provide an opportunity to update beneficiaries' accounts and correct possible mistakes in application processing before the next payment is issued.

6.42 We examined selected key reports to determine whether they received the required follow-up in the processing centres we visited:

- Edit and Update Reports list actions and updates to the OAS processing system that have not been properly accepted or for which the information entered into the system is incompatible.
- The Month End Report is a series of about 10 individual lists identifying situations requiring action to ensure that data on file accurately reflects beneficiaries' situations. Various actions may be required:
  - Beneficiaries becoming eligible for new benefits may need to submit an application or update their income and residence history.
  - Beneficiaries may need to confirm their address and residence history to ensure that they continue to be eligible for benefits.
  - For an incomplete application, staff need to determine the cause of the delay in supplying information and ensure prompt processing.

- Beneficiaries whose benefits have been suspended may need to be contacted for updated information.

- The Death Code Discrepancy Report lists cases in which the Canada Revenue Agency has a date of death for a GIS or Allowance beneficiary, but the OAS processing system does not yet have a date of death for that individual.

6.43 We found that different processing centres manage all of these reports in different ways and do not always fully understand their content and purpose. Some processing centres did not take prompt follow-up action on entire sections of the reports. We examined a non-statistical sample of 163 accounts listed in reports previously reviewed by service delivery agents. In 10 percent of the cases, the action taken was incomplete or incorrect, resulting in payment errors in 7 accounts. In another 10 percent, the follow-up had not been completed within the subsequent month. These results cannot be extrapolated to the general population of OAS beneficiaries' accounts. None of the processing centres had conducted quality reviews of the way they handled their automated reports.

6.44 At the time of our examination, Service Canada had begun a review of all OAS system reports. This project involved identifying the reports, reviewing their content and use, and publishing an updated set of procedures on how to manage them. The organization expected to complete this project by the end of March 2006.

Approaches to assess continuing eligibility vary

6.45 Once applications are accepted, Service Canada needs to know whether beneficiaries continue to be eligible. We found that different processing centres have substantially different ways of assessing continuing eligibility:

- We noted considerable variation in practices followed by service delivery agents when deciding whether to change the status of a beneficiary's OAS pension from non-portable to portable. A pension is non-portable if the beneficiary has resided in Canada for less than 20 years when the pension is approved; in other words, payment will stop if the beneficiary leaves Canada. In this case, if the beneficiary continued to live in Canada after approval until meeting the 20-year residence rule, the pension would become portable. This means that the beneficiary may move outside Canada and continue to receive the benefit (Exhibit 6.3). However, procedures are not clear on the extent to which beneficiaries who move outside the country are required to

provide documentation to demonstrate that they had resided continuously in Canada from the date when the pension was first granted until the date when the benefit became portable. We found that some beneficiaries were required to provide documentation of their continuing residence in Canada after initial approval of their pension, while others were not asked for documentation.

- Service Canada issues T4A tax slips to beneficiaries for use in reporting the income they have received under the OAS program. Tens of thousands of these slips are returned by Canada Post, indicating that Service Canada's information about beneficiaries' addresses is not up to date. Only one of the four processing centres that we visited followed up on the returned slips to update information for the beneficiaries concerned. In that processing centre more than 20,000 slips were returned in 2004 and 2005, representing about four percent of OAS beneficiaries in the region. In following up on these slips, the processing centre was able to update its information on about two percent of beneficiaries in the region and confirmed that it had already received updated information on the rest.

6.46 Recommendation. Service Canada should review the approaches it currently uses to assess beneficiaries' continuing eligibility and should ensure that the necessary approaches are applied consistently in all processing centres.

Service Canada's response. National tools are being revised and issued to assist in the establishment of coherent and consistent national approaches to service delivery. As part of that ongoing effort, Service Canada will ensure that common procedures are implemented for returned taxation slips and for absences from the country for beneficiaries who have less than 20 years' residence.

Efforts have been made to strengthen investigations

6.47 Where service delivery agents review beneficiaries' accounts and are unable to confirm eligibility, or where they suspect fraud, they refer such cases to designated investigators. At the time of our visits in August and September 2005, each region organized its investigation function differently. Some had full-time investigators; some combined the function with other activities. Guidance on conducting investigations was last updated in 2001. Each region tracked its investigations differently, and Service Canada therefore could not measure or compare whether regions were conducting investigations effectively.

6.48 In October 2005 Old Age Security and Canada Pension Plan investigators merged with Employment Insurance investigators in a single Service Canada Integrity Services Branch. The Branch told us that as a result, the investigation function is now organized more consistently across regions. The Branch further told us that investigators have better access to the more current guidance and training provided to Employment Insurance investigators, and information from investigations is being collected and reported to national headquarters in a more consistent way. Information from investigations is also being incorporated into the work under way toward developing a national risk management plan by July 2006.

Monitoring program performance

Information on payment accuracy and service quality has gaps

6.49 Human Resources and Social Development Canada and Service Canada use a range of performance information to manage their delivery of the Old Age Security program. However, there are some important gaps in the information.

6.50 **Payment accuracy.** There is no national measure of payment accuracy. The four regions we visited indicated that they use results from their regional quality reviews and one-time reviews undertaken at the direction of national headquarters to obtain information on payment accuracy. But because the approaches to quality review vary by region, they do not provide a national view, nor do they allow comparison across regions or from one period to another. The findings cannot readily be used to identify better practices or performance at the national level, or to assess the impact of local efforts toward improving payment accuracy.

6.51 **Service delivery.** Human Resources and Social Development Canada and Service Canada measure and publicly report on nationwide delivery of the OAS program using two key performance indicators:

- the percentage of OAS benefits paid within the first month of entitlement, and
- the percentage of telephone callers answered by a service delivery agent within three minutes.

6.52 Neither performance indicator provides a complete picture of the service area it measures. The first-month indicator is used to measure the timeliness of processing of OAS pension applications alone—not GIS or Allowance applications, although they account for about 30 percent of applications for OAS program benefits. The

indicator of answering a phone call within a three-minute waiting period overstates performance because it does not include callers who receive a busy signal, and it counts as a successful result a call where the caller hangs up before the three-minute period is over. Departmental data indicates that the overstatement of performance may be in the range of 10 percent of callers per year.

6.53 To provide broader information on service delivery, in 2005 Service Canada implemented a national workload reporting system. Three of the processing centres we visited use an information system to track their workload and provide monthly reports to national headquarters. The fourth produces the necessary information by manually counting work outstanding. This information gives early warning that backlogs may be developing in the processing of all types of OAS program applications and in the activities needed to update beneficiaries' files.

6.54 **Client satisfaction.** Information on client satisfaction with the delivery of the OAS program has not been collected regularly and consistently. In 2001 Human Resources and Social Development Canada (then Human Resources Development Canada) surveyed clients about their satisfaction with OAS service delivery. The survey investigated several measures of overall satisfaction with the service received, including satisfaction with different service channels. However, the Department has not conducted any further national surveys of client satisfaction with the program.

6.55 Two combined measures of client satisfaction with OAS and the Canada Pension Plan are included in the government-wide Citizens First Survey, which has been conducted about every two years since 1998. The survey is performed by an external organization across a broad range of federal government programs. Its results are therefore not readily comparable to the 2001 departmental survey. Service Canada conducted a client satisfaction survey across all of its main product lines in March and April 2006. At the time of the audit, it was not clear how the results of the survey would be reported and therefore whether they could be compared with the earlier program-specific or Citizens First surveys.

6.56 **Program evaluation.** An evaluation of the effectiveness of the GIS and Allowance was begun in 2001. An interim report was prepared in 2003. Human Resources and Social Development Canada plans to complete the evaluation in 2007.

6.57 **Reporting to Parliament.** The Department uses only the two key service delivery performance indicators to report its results in its departmental performance report, submitted annually to Parliament. These provide an incomplete view of the performance of the Old Age Security program.

Plans to improve performance measurement are in place

6.58 In both its 2004–05 and 2005–06 reports on plans and priorities, Human Resources and Social Development Canada stated that it was developing new performance indicators. We found that Human Resources and Social Development Canada and Service Canada were making progress in developing new performance information frameworks and measurement tools to manage the program and report to Parliament. The frameworks we reviewed would provide improved information on payment accuracy and service to beneficiaries.

6.59 The challenge is to develop ways of measuring performance, ensure the quality of the information, and implement the new frameworks as scheduled. Plans called for reporting on an initial set of revised performance indicators in spring 2006.

Managing overpayments

6.60 An OAS overpayment is the payment of a benefit to a beneficiary who is not entitled to receive it, or the payment of an amount exceeding what the beneficiary is entitled to receive. The *Old Age Security Act* requires beneficiaries to return overpayments. Common causes of overpayments are

- incorrect estimates of income for GIS and Allowance payments,
- late notifications of changes in marital status,
- errors by beneficiaries and Service Canada staff, and
- late notifications of death.

6.61 Service Canada's processing centres are generally responsible for identifying, recording, and collecting overpayments. However, roles and responsibilities vary by centre.

Information for managing overpayments is limited

6.62 The Departmental Accounts Receivable System of Human Resources and Social Development Canada and Service Canada does not handle OAS overpayments. As a result, the information normally available for managing overpayments is limited to monthly totals and lists of individual overpayment accounts. As of 31 March 2005, the amount

outstanding in overpayments of OAS benefits was about $82 million. This represents overpayments that Human Resources and Social Development Canada had not yet recovered, written off, or forgiven.

6.63 Information on the total amount of overpayments managed during each year—that is, new overpayments identified and collected, as well as those still outstanding—is not consolidated to provide a yearly or national picture. Limited analysis is undertaken of differences in the amounts and age profile of overpayments by year, benefit, or region.

6.64 Without this kind of information, overpayments cannot be managed adequately. For example, with data obtained from the OAS information system we found that overpayments have remained outstanding for longer periods. From March 2003 to March 2005, the proportion of overpayments older than five years increased from 14 to 21 percent of total outstanding overpayments. In the absence of information on the overpayments portfolio as a whole, it is impossible to determine whether this reflects a decrease in the effectiveness of collection efforts or an increase in the amount of overpayments. An increase in older overpayments is of particular concern since they are harder to collect.

Procedures for collecting overpayments need to be improved

6.65 Sometimes a beneficiary has not repaid an overpayment and continues to receive a benefit. Human Resources and Social Development Canada's overpayment policy sets guidelines for the collection process to ensure that beneficiaries repaying overpayments are treated consistently and equitably:

- Normally, recovery of the full amount is to be attempted first.
- The overpayment is to be recovered within 5 years or, if the overpayment is greater than $10,000, within 10 years. Recovery is to begin promptly through monthly deductions from benefits, after informing the beneficiary of the overpayment and allowing one month for a reply.
- If the beneficiary would suffer undue financial hardship from application of the preceding provision, the recovery period may be extended beyond 5 or 10 years, but a minimum payment of $10 per month must be established and the account must be reviewed every 6 to 12 months to determine whether a higher recovery rate is possible.

6.66 We found that these guidelines were not applied consistently from one processing centre to another:

- One processing centre accounted for 5 percent of the overpayment cases in which beneficiaries continued to receive benefits. At the same time, the centre accounted for 38 percent of the national total of these cases where a recovery rate was not set within two months.
- Another processing centre accounted for two thirds of all cases with a recovery rate set below the $10 monthly minimum. Officials in the centre told us that they did not always take into account the 5- and 10-year limits or the $10 minimum when setting monthly recovery rates.
- Practices differed for recovering overpayments issued because of **erroneous advice** or **administrative error**. One processing centre we visited attempts to recover any such overpayment before forgiving the debt. Another generally forgives the debt immediately but sometimes attempts to recover the amount first.

Erroneous advice—Communication to beneficiaries that contains an error or omits key information.

Administrative error—Clerical or computer error, wrong decision, or failure to follow procedures.

6.67 In our 1993 Report, Chapter 18, Department of National Health and Welfare—Programs for Seniors, we stated that the systems and procedures for recording and collecting overpayments were inadequate. We based our conclusion on the fact that neither the national headquarters of the former Department of National Health and Welfare (then responsible for the OAS program) nor its regions regularly monitored the amounts outstanding in overpayments, the actions taken to recover them, or the amounts collected. Existing systems did not allow managers to quantify overpayments or manage their recovery efficiently, and the Department was not organized for the recovery of overpayments. The current audit found that these problems persist.

6.68 Human Resources and Social Development Canada is updating its policy on administrative error and erroneous advice, as well as its overpayment policy. It has been developing the new policy on administrative error and erroneous advice since spring 2005, and the new overpayment policy since 2001.

Legislative provisions need to be applied

6.69 **No interest is charged on OAS overpayments.** The *Financial Administration Act* requires federal departments and agencies to charge interest on outstanding overpayments. Regulations made under the Act specify that interest should be charged if a debtor is not adhering

to a repayment schedule or if the case involves fraud. When the regulations were adopted in 1996, Human Resources and Social Development Canada (then Human Resources Development Canada) indicated that it would meet this requirement in 1999. Instead of doing so, in 2000 the Department adopted a policy of charging interest only in cases of fraud or misrepresentation. However, it never made the legislative changes necessary to implement the policy. The result is that Human Resources and Social Development Canada and Service Canada do not comply with the legislative requirement to charge interest on overpayments.

6.70 Policies needed to implement the penalty provisions of the *Old Age Security Act* have not been completed. The Act was amended in 1998. One of the amendments, which would enable Human Resources and Social Development Canada to charge penalties in cases of deliberate omission or misrepresentation, was not put into force so that the Department could develop necessary policies and procedures. Work was begun on the policies and procedures, but eight years later it has not been completed.

6.71 Recommendation. Human Resources and Social Development Canada and Service Canada should take steps to improve their management of overpayments. These steps should include

- consolidating, analyzing, and acting on information on overpayments and collections;
- completing the review of their overpayment policy and ensuring that it is applied consistently;
- complying with the requirements of the *Financial Administration Act* concerning the charging of interest on outstanding overpayments; and
- finalizing policies and procedures to permit the implementation of the penalty provisions of the *Old Age Security Act*.

Human Resources and Social Development Canada's and Service Canada's response. Measures are being introduced to ensure that processes for managing information on overpayments are rigorous and meet reporting requirements. Existing systems, with appropriate checks built in, will be used until the migration of Old Age Security program information to the Departmental Accounts Receivable System.

Human Resources and Social Development Canada acknowledges the need to review its policy on overpayments and integrate new statutory

requirements. In addition, the policy will be revised where required to ensure coherence of application. This will be supplemented by review sessions with involved areas to support a common understanding. It is expected that a new draft policy will be completed by the end of 2006–07.

The Department is seeking the earliest opportunity to amend the *OAS Act* to comply with *Financial Administration Act* requirements. Given the limited financial resources of most pension recipients, the departmental position has been that public pensions programs should be exempt from the general requirement to charge interest on overpayments, except in cases of fraud or misrepresentation. Human Resources and Social Development Canada has identified a list of potential legislative initiatives for fall 2006, which includes a proposed amendment to the *OAS Act*. This amendment would grant regulation-making authority to exempt the charging of interest on outstanding overpayments in certain circumstances.

Human Resources and Social Development Canada and Service Canada will also take steps to finalize appropriate policies and procedures to permit the implementation of penalty provisions at the earliest possible opportunity. Human Resources and Social Development Canada and Service Canada recognize the need to implement appropriate penalty provisions within the *OAS Act* in cases of deliberate omission or misrepresentation. The current *OAS Act* sections on penalties, not yet in force, contain provisions that may create administrative complexities. Both organizations are reviewing these sections and will take legislative action, at the earliest available opportunity.

Subsequent events

6.72 We completed the fieldwork for this audit in October 2005 and obtained responses to the recommendations from Human Resources and Social Development Canada and Service Canada in May 2006. However, because the reporting date of the audit was rescheduled, in August 2006 we obtained and assessed information from both organizations on what action, if any, they may have taken to address the observations and recommendations in the audit report.

6.73 Program evaluations (6.18 and 6.56). We were informed that, as of August 2006, planning for the evaluation of GIS take-up was progressing, but the expected completion date was not until December 2007. An evaluation of the outreach program was still planned for 2008–09, and completion of the GIS and Allowance evaluation was still intended for the end of 2007.

6.74 National risk management plan (6.27 and 6.48). Service Canada informed us that it had continued to develop an Enterprise-Wide Operational Risk Management approach. Existing information sources continued to be reviewed to identify and assess risks. Next steps planned by March 2007 include piloting new risk management approaches, ensuring that planned approaches are consistent with privacy requirements, and improving data analysis.

6.75 Quality review of processing (6.39 and 6.40). Service Canada informed us that in February and March 2006, it had conducted a national quality assurance survey of OAS program beneficiaries' files, using a statistical sample of 425 files. The purpose was to establish a benchmark for future quality surveys. As of August 2006, validation of the results had not been completed. Service Canada told us it plans to conduct similar surveys periodically to assess the effectiveness of its risk mitigation strategies. While the results of such surveys would not be statistically valid at the regional level, Service Canada was planning to implement a national quality review system with standardized procedures for use by regional processing centres by the end of March 2007.

6.76 In March and April 2006, Service Canada conducted a review of OAS program beneficiaries' files using a statistical sample of 2,370 files. The purpose was to verify that benefits were paid to eligible recipients in the correct amounts. A review of this size had not been conducted in previous years. The audit approach was similar to our test of applications, but covered all beneficiaries who received a pension between April 2005 and January 2006. The review addressed only the proportion of payment errors, not the proportion of quality deficiencies. The review estimated that a maximum of one percent of benefits could have been paid in error.

6.77 Updating accounts and assessing continuing eligibility (6.44 and 6.46). By August 2006, the review of OAS system reports had been completed. Revised procedures and expectations for managing the reports had not yet been provided to OAS processing centres. No new guidance had been provided to processing centres concerning returned taxation slips or absences from the country of beneficiaries with less than 20 years' residence. Service Canada informed us that it would determine what action to take on procedures for ensuring continuing eligibility based on the results of the national quality assurance survey.

6.78 Performance information (6.55 and 6.59). In August 2006, Human Resources and Social Development Canada and Service

Canada were continuing to re-examine performance indicators for the OAS program. They had not yet begun reporting against revised indicators but planned to provide revised and expanded performance information for Parliament and the public in fall 2007. We were told that this information would include the results of Service Canada's 2006 survey of client satisfaction. Service Canada considered that the client satisfaction survey would provide an initial baseline of client satisfaction and would therefore not be comparable with the 2001 departmental survey or the Citizens First surveys. Thus, Service Canada will not yet be able to report trends in client satisfaction with the delivery of the OAS program.

6.79 **Overpayments (6.71).** Service Canada informed us that by August 2006, it had made changes to its information systems and procedures to improve the information available on overpayments. Human Resources and Social Development Canada said it was continuing to review its overpayment policy and planned to develop a new draft policy by March 2007. It also said it was pursuing a legislative change to the *OAS Act* for the fall of 2006, including amendments with respect to the *Financial Administration Act* requirement to charge interest on overpayments. Until these measures are completed, however, the organizations will not be in compliance with the legislative requirement to charge interest on outstanding overpayments. Both organizations said that the legislative initiative contains further amendments to the current penalty provisions of the *OAS Act*. Service Canada is concurrently finalizing the necessary policies and procedures to implement penalty provisions for the OAS program.

Conclusion

6.80 Human Resources and Social Development Canada and Service Canada make millions of Old Age Security program benefit payments to millions of beneficiaries every year. However, delivery of the program would benefit from improvements in some areas.

6.81 The organizations make information about the OAS program available and provide access to services in ways that meet beneficiaries' needs. They nonetheless need to strengthen their performance information on these and other aspects of their service to clients, and they need to use this information to present a more complete picture of program performance to Parliament.

6.82 Quality reviews in processing centres, as well as our own testing, suggest that errors in establishing payment amounts at the time of application occur at relatively low rates. However, it is not known whether this will continue, given that payment accuracy is not systematically measured. Quality deficiencies, which may lead to payment errors, occur at rates that vary substantially. Practices for updating accounts and assessing continuing eligibility also are not consistent from one processing centre to another. These variations signal a need for regular monitoring of the quality of application processing to ensure that payment error rates remain controlled.

6.83 Human Resources and Social Development Canada and Service Canada have identified key areas where payment accuracy may be at risk, but they have not completed an assessment of these risks. The organizations are developing a national risk management approach to identify and assess risks systematically, design appropriate control mechanisms, and monitor the risks.

6.84 Improving the management of payment accuracy would also improve the organizations' ability to identify overpayments promptly. However, Human Resources and Social Development Canada and Service Canada do not have the consolidated information they need to properly manage overpayments. They do not collect overpayments across all processing centres in a consistent way. We identified some of these problems several years ago. Further, the two organizations do not comply with legislation requiring them to charge interest on OAS overpayments.

6.85 In many of the areas examined by this audit, Human Resources and Social Development Canada and Service Canada have begun to take action to strengthen their management of the OAS program. By the end of 2007, they indicated that they will have collected and reported improved information on client satisfaction and services, implemented a national quality review system, and improved information on overpayments. They also plan to issue a revised policy on managing overpayments.

About the Audit

Objectives

The objectives of the audit were to determine whether

- Human Resources and Social Development Canada and Service Canada make information about the Old Age Security program available and provide access to services in ways that respond to beneficiaries' needs;
- the systems and practices for determining initial benefit eligibility and for monitoring continuing eligibility provide reasonable assurance that eligible individuals receive the correct Old Age Security program benefits; and
- overpayments of Old Age Security program benefits are identified, collected, or forgiven in accordance with applicable legislation and policies.

Scope and approach

The Old Age Security program benefits include the pension, the Guaranteed Income Supplement, and the Allowance for spouses or survivors. Our audit focused on the systems and practices used by Human Resources and Social Development Canada and Service Canada to manage and deliver these benefits.

- We examined how the two organizations ensure that all persons eligible for benefits have access to the program.
- We examined how they identify risks to payment accuracy and how they control those risks.
- We examined how national and regional procedures for identifying, collecting, and forgiving overpayments meet the requirements of legislation and policy.
- Finally, we examined performance information and reporting to Parliament.

We did not examine the clawback of OAS pension benefits paid to high-income beneficiaries; this is managed by the Canada Revenue Agency.

We interviewed officials and reviewed documents at the national headquarters of Human Resources and Social Development Canada and Service Canada. We also interviewed officials and reviewed documents in regional offices of the two organizations in British Columbia, Newfoundland and Labrador, Ontario, and Quebec. The processing centres we visited delivered 47 percent of total program benefits in 2004–05.

Other federal organizations contribute to the management and delivery of the program. We therefore reviewed documents and met with officials of the Canada Revenue Agency, the Canada Border Services Agency, Statistics Canada, and the Treasury Board of Canada Secretariat.

In addition, we conducted file reviews for a representative sample of OAS benefit applications to determine whether Human Resources and Social Development Canada and Service Canada service delivery agents followed correct procedures for validating documents and verifying applicants' eligibility. We randomly selected 400 applications for OAS program benefits from a total of 73,769 applications

processed between April and June 2005. The sample was stratified and non-proportional. The population estimates reported in this audit have been appropriately weighted to reflect the distribution of the national population.

We analyzed Service Canada's internal processing reports and overpayment data and requested targeted data from the OAS and Canada Pension Plan systems. Our purpose was to identify populations of beneficiaries with profiles presenting a higher risk of incorrect benefit payments.

Criteria

Our audit was based on the following criteria:

- Human Resources and Social Development Canada has reliable information on the costs and effectiveness of measures to increase take-up.
- Information on program benefits is easy to find, and access is offered through channels that meet beneficiaries' needs.
- Beneficiaries receive the benefits to which they are entitled in ways that are accessible and convenient.
- Human Resources and Social Development Canada identifies and mitigates risks to the integrity of program benefits.
- Program benefits are paid in accordance with legislation and policy.
- Overpayments are identified, recorded, and collected in accordance with legislation and policy.
- Overpayments are written off or remitted in accordance with legislation and policy.
- Performance information is gathered and used to provide early warning of problems for all key aspects of service to beneficiaries, payment accuracy, and management of overpayments.

Audit work completed

Audit work for the chapter was substantially completed on 31 October 2005. Validation of the subsequent events information was substantially completed on 31 August 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 6. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Departments' responses
Determining benefits	
6.39 Service Canada should implement a nationally standardized quality review system for applications for OAS program benefits, covering all types of applications and other key processing activities. (6.28–6.38)	**Service Canada's response.** With the introduction of Service Canada enterprise-wide approaches, work is under way to conduct a baseline assessment of quality review processes. In 2006–07 a national quality review program will be introduced.
6.40 Until a standardized approach is in place, Service Canada should direct its processing centres to apply existing quality review procedures more systematically. (6.28–6.38)	**Service Canada's response.** The national quality review system to be implemented in 2006–07 will include standardized procedures for use by regional processing centres.
6.46 Service Canada should review the approaches it currently uses to assess beneficiaries' continuing eligibility and should ensure that the necessary approaches are applied consistently in all processing centres. (6.41–6.45)	**Service Canada's response.** National tools are being revised and issued to assist in the establishment of coherent and consistent national approaches to service delivery. As part of that ongoing effort, Service Canada will ensure that common procedures are implemented for returned taxation slips and for absences from the country for beneficiaries who have less than 20 years' residence.

Recommendation	Departments' responses
Managing overpayments	
6.71 Human Resources and Social Development Canada and Service Canada should take steps to improve their management of overpayments. These steps should include • consolidating, analyzing, and acting on information on overpayments and collections; • completing the review of their overpayment policy and ensuring that it is applied consistently; • complying with the requirements of the *Financial Administration Act* concerning the charging of interest on outstanding overpayments; and • finalizing policies and procedures to permit the implementation of the penalty provisions of the *Old Age Security Act*. **(6.60–6.70)**	**Human Resources and Social Development Canada's and Service Canada's response.** Measures are being introduced to ensure that processes for managing information on overpayments are rigorous and meet reporting requirements. Existing systems, with appropriate checks built in, will be used until the migration of Old Age Security program information to the Departmental Accounts Receivable System. Human Resources and Social Development Canada acknowledges the need to review its policy on overpayments and integrate new statutory requirements. In addition, the policy will be revised where required to ensure coherence of application. This will be supplemented by review sessions with involved areas to support a common understanding. It is expected that a new draft policy will be completed by the end of 2006–07. The Department is seeking the earliest opportunity to amend the *OAS Act* to comply with *Financial Administration Act* requirements. Given the limited financial resources of most pension recipients, the departmental position has been that public pensions programs should be exempt from the general requirement to charge interest on overpayments, except in cases of fraud or misrepresentation. Human Resources and Social Development Canada has identified a list of potential legislative initiatives for fall 2006, which includes a proposed amendment to the *OAS Act*. This amendment would grant regulation-making authority to exempt the charging of interest on outstanding overpayments in certain circumstances. Human Resources and Social Development Canada and Service Canada will also take steps to finalize appropriate policies and procedures to permit the implementation of penalty provisions at the earliest possible opportunity. Human Resources and Social Development Canada and Service Canada recognize the need to implement appropriate penalty provisions within the *OAS Act* in cases of deliberate omission or misrepresentation. The current *OAS Act* sections on penalties, not yet in force, contain provisions that may create administrative complexities. Both organizations are reviewing these sections and will take legislative action, at the earliest available opportunity.

Report of the Auditor General of Canada to the House of Commons—November 2006

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Report of the Auditor General of Canada to the House of Commons

NOVEMBER

Chapter 7
Federal Participation in the British Columbia Treaty Process—Indian and Northern Affairs Canada

Office of the Auditor General of Canada



2006



Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Chapter 7

Federal Participation in the British Columbia Treaty Process—Indian and Northern Affairs Canada

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.



The Report is available on our website at www.oag-bvg.gc.ca.

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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-7E
ISBN 0-662-44371-3

Chapter

7

Federal Participation in the British Columbia Treaty Process

Indian and Northern Affairs Canada

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Federal Participation in the British Columbia Treaty Process

Indian and Northern Affairs Canada

Foreword

The reconciliation of Aboriginal rights and title to land with the assertion of sovereignty by the Crown in the province of British Columbia (B.C.) has been a long-standing issue. Despite several attempts by Canada, B.C. and First Nations to resolve this issue, a solution satisfactory to all has yet to be found. This matter has far-reaching implications for B.C. as it affects and raises questions about the use, management, and regulation of land and resources and the laws that apply to the land and the people.

In 1992, Canada, B.C. and the First Nations Summit, representing the First Nations involved in the process, created the B.C. treaty process. This process is aimed at building a relationship with B.C. First Nations based on respect and trust that will result in treaties, thus settling the uncertainty associated with unresolved land claims in B.C.

Initially, the federal government expected that all claims in B.C. would be resolved by the year 2000. Today, about 40 percent of eligible B.C. First Nations, or *Indian Act* bands, representing about 30 percent of their population, do not participate in the process.

At the federal level, Indian and Northern Affairs Canada (INAC) represents Canada in the B.C. treaty negotiations. About 40 other federal departments and agencies provide assistance to INAC. At the provincial level, the B.C. Ministry of Aboriginal Relations and Reconciliation has the primary responsibility for negotiating treaties on behalf of the province, with assistance from various other ministries.

The Auditors General of Canada and British Columbia are tabling separate audit reports to their respective legislatures on the management of the B.C. treaty process. The Auditor General of Canada primarily examined the procedures and the resources being used by the federal government to negotiate treaties. The Auditor General of British Columbia examined whether the provincial government has effective administrative processes and resources in place to negotiate treaties successfully. Both Auditors General focused on the results of their respective government's activities.

The two audits were performed concurrently to present a broader perspective on the treaty process. Our offices shared methodologies and met jointly with First Nations and other organizations.

Limited results

Although progress is being made at some negotiation tables, with two final agreements seen as imminent and a third close behind, the process has not yet resulted in any treaties with First Nations. After spending hundreds of millions of dollars over more than 12 years of negotiations, the results achieved are well below the three parties' initial expectations. In the last few years, however, efforts have been made by the two governments to improve the treaty process.

Differing views

Successful negotiations require that the participants share a common vision of their relationship and of the future. Our two audits found that the participants have differing views on the nature of the treaties being negotiated. For example, the two governments base their participation in the treaty process on their own policies, and do not recognize the Aboriginal rights and title claimed by the First Nations. Many First Nations base their participation in the process on the assertion that they have Aboriginal rights under Canada's Constitution and that these rights should be acknowledged before negotiations begin. Additionally, the governments see treaties as a full and final settlement of the Aboriginal rights and title claimed by First Nations, whereas First Nations see them as documents capable of evolving as the relationship between the parties develops.

These differences limit progress at a number of treaty negotiation tables and contribute to the fact that about 40 percent of the First Nations that could enter the treaty process have not done so.

Evolving context

We have noted that, in the absence of treaties, other options have evolved to deal with questions related to Aboriginal rights and title, although in many cases, these solutions are temporary. Both audits noted that some court decisions may make litigation a more attractive option than negotiation. A rising number of contracts between First Nations and the federal and provincial governments, municipalities, and private companies was observed. The audits also noted the endorsement by B.C. and the three organizations representing all B.C. First Nations of the document entitled "A New Relationship," which outlines how a new "government-to-government" relationship will be established between B.C. and First Nations based on respect, recognition, and the accommodation of Aboriginal rights and title.

As a result of these other legal, economic, and political options, it is challenging for the federal and B.C. provincial governments to offer

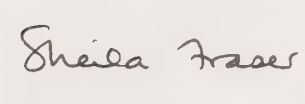
benefits to First Nations that meet or exceed those available outside the treaty process.

Need for review

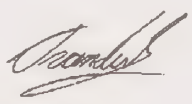
Progress continues to be slow and there is a risk that the treaty process, as it exists today, may be overtaken by the changing legal, economic, and political environments in which the negotiations are taking place. At this point, we believe that signing treaties with most B.C. First Nations based on the treaty process as it currently exists will continue to be difficult.

In our view, however, negotiations remain an effective means by which the parties can build the new relationship they are seeking and resolve their claims. As Supreme Court of Canada Chief Justice Lamer stated in the landmark 1997 *Delgamuukw* decision: "Ultimately, it is through negotiated settlements, with good faith and give and take on all sides, reinforced by the judgments of this Court, that we will achieve (...) the reconciliation of the pre-existence of aboriginal societies with the sovereignty of the Crown."

We call on our respective governments, working together and with First Nations, to take action to address our recommendations.



Sheila Fraser, FCA
Auditor General of Canada



Arn van Iersel, CGA
Acting Auditor General of British Columbia

The report *Treaty Negotiations in British Columbia: An Assessment of the Effectiveness of British Columbia's Management and Administrative Processes* is available on the Office of the Auditor General of British Columbia website at www.bcauditor.com. For copies, contact

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Federal Participation in the British Columbia Treaty Process

Indian and Northern Affairs Canada

Main Points

What we examined

The British Columbia treaty process is intended to reconcile claimed Aboriginal rights and title to land with the Crown's assertion of sovereignty. The resulting treaties are aimed at settling uncertainty about the use, management, and regulation of land and resources and the laws that apply to the land and the people. Indian and Northern Affairs Canada (INAC) represents the federal government in the B.C. treaty negotiations. First Nations (individual communities or groups) and the Province of British Columbia are the two other parties in these negotiations.

We examined INAC's participation in the treaty process and the results of its activities. We looked at the management procedures and processes and the resources used to develop and implement federal policies that apply to treaty negotiations; our audit also covered, where relevant, support provided to the treaty process by other federal departments. We interviewed officials of INAC and of other departments and reviewed relevant files and documents; we also sought the views of First Nations communities and organizations and of the British Columbia Treaty Commission.

Why it's important

From 1993 to 2006 the federal government has spent about $426 million on B.C. treaty negotiations, and B.C. First Nations have borrowed close to $300 million for the same purpose. To date, no treaties have been signed under the B.C. treaty process, although two final agreements are seen as imminent, with a third close behind. The costs to Canada and First Nations for negotiations continue to grow.

Settling the uncertainty associated with unresolved land claims in British Columbia is important for all Canadians. It can help First Nations people living in B.C. narrow the gap between their standard of living and that of other British Columbians. In addition, studies have indicated that this uncertainty results in lost economic opportunities.

What we found

- While some treaties are expected to be signed in the near future, most negotiations are either inactive or are making limited progress. Moreover, about 40 percent of First Nations (*Indian Act* bands) are not participating in the treaty process, and there is a growing number of activities outside the process that are being used to deal with questions related to Aboriginal rights and title.
- Although the policy process has been able to respond to some issues raised during negotiations, several other issues remain to be addressed. For example, due to changes in the legal environment, dealing with overlapping claims may make concluding treaties more complex.
- In 1991 the federal government expected that all land claims in B.C. would be resolved by the year 2000. As of 2006, no treaties have been signed under the B.C. treaty process and INAC does not have the management systems in place to be able to estimate how much time and what resources will still be needed to negotiate treaties with First Nations and groups presently in the process.

The Department has responded. Indian and Northern Affairs Canada has accepted all of the Auditor General's recommendations and has committed to take action. The Department's responses follow the recommendations throughout the chapter.

Introduction

7.1 The reconciliation of Aboriginal rights and title to land with the assertion of sovereignty by the Crown in the province of British Columbia (B.C.) has been a long-standing issue. It affects and raises questions about the use, management, and regulation of land and resources and the laws that apply to the land and the people.

7.2 Resolving the land question in B.C. is important to First Nations and to the federal government. First Nations, for example, state that as resource exploitation in their claimed territories continues during treaty negotiations, there will not be enough lands and resources to maintain their culture and livelihood. The federal government expects that the fair and timely resolution of B.C. land claims through negotiated treaties will clarify rights to land and resources in the province.

7.3 The lack of treaties results in lost economic opportunities. Studies by private consulting firms have found that the uncertainty over unresolved land claims is a major drain on the B.C. economy and that treaties would result in significant gains to the economy.

Historical background

7.4 Before the land now known as British Columbia became a province of Canada in 1871, 14 land purchases were made from Aboriginal people by Sir James Douglas, chief factor of the Hudson's Bay Company and later governor of the Crown colony of Vancouver Island. After B.C. joined Canada, the federal government assumed responsibility for Indians (members of "First Nations") and B.C. retained authority over land and resources in the province. The union created difficulties between the two governments and with First Nations. In 1876, B.C. and Canada established a joint commission to examine and allot Indian reserves in B.C. In 1912, a federal–provincial commission was established to "settle all differences between [the Government of Canada and the province] respecting Indian Lands and Indian Affairs generally in [B.C.]". Over time, dissatisfaction mounted among B.C. First Nations concerning how land rights and other issues were being handled. In 1916, a province-wide Aboriginal organization, the Allied Tribes of B.C., was formed to pursue First Nations' rights. Over the years, several First Nations pressed their cases in Victoria, Ottawa, and London, England.

7.5 Between 1871 and 1921, the federal government signed 11 treaties with First Nations, mostly in Ontario and the Prairie provinces. Only one of them, Treaty 8, signed in 1899, covers a portion

of B.C. In the meantime, in 1876, the *Indian Act* was passed, consolidating all previous legislation concerning Indians.

7.6 In 1969, the Nisga'a went to court seeking a declaration that Aboriginal title to their land in northwestern B.C. had not been "extinguished." In 1973, the Supreme Court of Canada ruled, in the *Calder* case, that the Nisga'a held Aboriginal title before the British established sovereignty, but the court split evenly on whether this title had been "extinguished" when B.C. joined Canada.

7.7 In 1973, in the wake of this landmark ruling, the federal government established its policy on comprehensive land claims. This policy was revised in 1981 and again in 1986 to become the Comprehensive Land Claims Policy. Under the policy, the federal government negotiates with First Nations a package of clearly defined rights and benefits in exchange for their claims to Aboriginal rights and title. According to INAC, 20 comprehensive land claim agreements (mostly in the three territories) covering about 40 percent of Canada's land mass have been concluded under this policy. These agreements involve more than 90 Aboriginal communities with more than 70,000 members. Among other benefits, these communities secured ownership for over 600,000 square kilometres of land and more than $2.4 billion in cash.

7.8 In 1982, the *Constitution Act's* section 35 recognized and affirmed existing Aboriginal and treaty rights. By 1990, the federal government had accepted 21 comprehensive land claims from B.C. First Nations for eventual negotiations, but actual negotiations were taking place only with the Nisga'a.

The treaty negotiation process

7.9 In December 1990, in response to growing frustration on the part of First Nations over the lack of progress in dealing with their land claims, Canada and B.C., with First Nations, created the B.C. Claims Task Force to define the scope, organization, process, and time frames for negotiations to resolve outstanding claims in B.C. The Task Force reported in 1991 and made 19 recommendations, which were endorsed by all three parties. Based on these recommendations, in 1992, the British Columbia Treaty Commission (BCTC) and the B.C. treaty process were established by agreement among Canada, B.C., and the First Nations Summit (representing First Nations involved in the process). The federal government expected that the tripartite B.C. treaty process would accelerate the settlement of comprehensive land claims in B.C.

7.10 The role of the BCTC is to oversee the six-stage B.C. treaty negotiation process (Exhibit 7.1). The Commission's responsibilities include

- administering funding for First Nations to participate in the treaty process, and allocating loans and contributions among them in accordance with criteria agreed to by the three parties;
- encouraging timely negotiations, and monitoring and reporting on their progress;
- identifying problems and offering advice; and
- assisting in resolving disputes, at the parties' request.

Exhibit 7.1 The six stages of the B.C. treaty process

Entry	**Stage 1**	A First Nation, or group of First Nations, submits to the British Columbia Treaty Commission (BCTC) a statement of intent to negotiate a treaty with British Columbia (B.C.) and Canada. Among other things, the statement identifies the people involved and the general geographic area of the First Nation's traditional territory, including where overlap may exist with other First Nations.
Preparation	**Stage 2**	The First Nation(s), B.C., and Canada (the parties) prepare for negotiations and submit to the BCTC their readiness documents. Negotiations begin when the Commission determines that the parties and the table have met the readiness criteria set out in the 1992 BCTC Agreement.
Negotiations	**Stage 3**	The parties negotiate a framework agreement that identifies the subjects, procedures, objectives, and time frames for reaching an agreement-in-principle.
	Stage 4	The parties negotiate an agreement-in-principle that addresses all the features of the eventual treaty settlement. This is usually the longest stage of treaty negotiations.
	Stage 5	The parties formalize, in a final agreement, the features of the eventual settlement as defined in the agreement-in-principle. The agreement also includes an implementation plan and financial arrangements. The final agreement must be approved first by the First Nation or group of First Nations, and then by the B.C. government and finally by Canada. The details of the ratification procedures are set out in the final agreement.
Implementation	**Stage 6**	Implementation of the final agreement officially begins once legislation is passed by the B.C. Legislature and federal Parliament.

Source: Various public documents

7.11 Excluding the Nisga'a Nation (already under treaty), there are 202 First Nations or *Indian Act* bands that could join the B.C. treaty process. This includes eight First Nations with populations living in the Yukon and Northwest Territories who are claiming land in B.C. Most of the province is potentially subject to claims under the process.

7.12 First Nations' participation in the treaty process is voluntary. About 60 percent of eligible First Nations or bands are currently involved in the process. Each First Nation determines how it wants to organize itself for the negotiations. Some First Nations have joined individually while others have joined as groups. First Nations have identified several challenges with the treaty process (Exhibit 7.2).

7.13 Financial support, mostly in the form of loans provided by Canada, is available to First Nations participating in the B.C. treaty process so that they can prepare for and carry out negotiations on a

Exhibit 7.2 First Nations' perspectives on treaty process challenges

First Nations in the treaty process
Negotiation funding. The accumulation of higher than expected negotiation loans has become one of the greatest obstacles to progress in treaty negotiations. This places First Nations at a disadvantage since governments are not under the same pressure to conclude negotiations.
Interim measures. Few measures have been implemented to postpone resource exploitation or to protect resources in a claimed territory while negotiations continue.
Dispute resolution. The treaty process lacks a dispute resolution mechanism for negotiation tables.
Community support. First Nations' support for treaty negotiations can be difficult to maintain in light of the complexity of negotiations, limited tangible results, growing debt loads, and the attention needed for other pressing social and economic problems.
Overlaps. Disputes can arise between First Nations claiming the same traditional territory.
Power imbalance. First Nations have limited capacity to negotiate all subjects that the two governments want to cover in treaties, while the governments have access to many experts.
Mandates. The federal government provides its negotiators with narrow and inflexible mandates that leave little room to negotiate on some issues.
Alternatives. Options outside of the treaty process have drawn some First Nations' attention away from the negotiation table. The relevance of treaty negotiations is questionable when other attractive options are available.

First Nations outside the treaty process
No recognition of rights. The treaty process has been flawed from the beginning because it does not acknowledge Aboriginal rights and involves the surrender of Aboriginal title.
Nature of treaty. The type of treaty offered is archaic and outdated and is not in keeping with the kind of relations that First Nations would like to establish with Canada.

Source: Interviews with First Nations and documents provided by them (unaudited)

more equal footing with the federal and provincial governments. As of 31 March 2006, $289 million in loans had been issued by the federal government to First Nations. At the end of March 2009, First Nations loans could reach over $375 million. These loans are expected to be repaid by First Nations from the cash portions of their treaty settlements.

Federal participation in the process

7.14 The federal government placed INAC in charge of the federal participation in treaty negotiations in B.C. According to the Department, Canada participates in the treaty process to negotiate fair, equitable, and affordable treaties with B.C. First Nations in a timely manner. These treaties aim to define a new relationship between Canada and First Nations, clearly setting out rights, responsibilities, obligations, and jurisdiction over people, lands, and resources.

7.15 **Organization.** In 1992, the Department created a unit, the Federal Treaty Negotiation Office (FTNO), located in B.C., to manage treaty negotiations in the province. The FTNO reports to the Department's Claims and Indian Government Sector, based in Ottawa. This sector is responsible for developing and implementing key federal policies covering the negotiation and implementation of comprehensive land claim agreements (and self-government agreements) and for negotiating these claims with First Nations across Canada.

7.16 The FTNO is responsible for carrying out most of the treaty negotiations and representing the interests of Canada at the negotiation tables. It has an annual budget of $15 million and a staff of about 100 people. The Department of Finance is responsible for negotiating the treaties' tax provisions. Annual funding totalling about $7 million is provided to other federal departments and agencies that assist INAC in negotiations. The federal government has spent about $426 million on the B.C. treaty process since its inception in 1993 (Exhibit 7.3). This includes some costs associated with the Nisga'a treaty, signed outside of the B.C. treaty process in 1999.

7.17 A key federal committee involved in the B.C. treaty process is the Federal Steering Committee on Self-Government and Comprehensive Claims, composed of assistant deputy ministers from relevant departments. The Committee provides policy direction and advice to negotiators. It also reviews proposed changes to mandates, and concluded agreements before their presentation to the government for approval.

7.18 Mandating. Federal negotiations are carried out by teams of federal officials, headed mostly by chief federal negotiators appointed by the Minister of Indian and Northern Affairs Canada. Two types of government-approved mandates (the government's instructions) are provided to federal negotiators. A generic mandate outlines key B.C.-wide aspects common to all negotiations with First Nations in B.C., such as the need to address land claims and self-government. When a particular negotiation is more advanced, the responsible chief federal negotiator seeks from the government a specific mandate quantifying certain items for negotiation, such as the amount of land and financial transfer that the government is willing to offer, and approval for exceptions, if any, to the generic mandate. Exhibit 7.4 summarizes key federal positions in the B.C. treaty negotiations.

7.19 Sharing costs with British Columbia. The formal coordination between Canada and B.C. is governed by a Memorandum of Understanding (MOU) signed in 1993. This agreement covers the sharing of pre-treaty costs, settlement costs, implementation costs, and the costs of self-government. The MOU's main purpose is to ensure, overall, that these costs are shared equally between the two governments. However, both governments remain responsible for their own negotiation costs.

Exhibit 7.3 **Federal costs for the B.C. treaty process (in $millions)**

	Actual 1993–94 to 2005–06	Planned 2006–07 to 2008–09	Total actual and planned 1993–94 to 2008–09
Federal funding for INAC and other federal departments and agencies	236.8[1]	66.7	303.5
Contributions to the British Columbia Treaty Commission and the First Nations Summit	34.3	9.3	43.6
Financial support to First Nations[2]	155.3	85.0	240.3
TOTAL B.C. treaty process[3]	**426.3**	**161.0**	**587.3**

Note: Figures may not add exactly due to rounding.

[1] Includes some costs associated with the 1999 Nisga'a treaty, negotiated outside of the B.C. treaty process. INAC did not track these costs separately.
[2] Includes contributions to First Nations to cover 20% of their negotiation costs, contributions for treaty-related measures and capacity development, and interest charges covered by INAC on outstanding loans to B.C. First Nations.
[3] Does not include outstanding loans to First Nations, which amounted to $289.2 million from 1993–94 to 2005–06. Loans to First Nations are anticipated to increase by $87.0 million from 2006–07 to 2008–09 for a total of $376.2 million.

Source: Indian and Northern Affairs Canada

Focus of the audit

7.20 Our audit covered primarily the management procedures and processes and the resources used by the federal government to negotiate treaties in B.C., and the results of those activities. It focused on Indian and Northern Affairs Canada, but also included, where relevant, the support provided to INAC by other federal departments involved in the process. Although we did not audit First Nations, we sought their views on the matters included in the audit through community visits and consultations. We also interviewed BCTC Commissioners.

Exhibit 7.4 Federal positions cover a wide range of topics

Land	• First Nations select additional land within their claimed territory; B.C. and Canada must agree with the amount of land selected and the location of this land. • Existing reserves and additional lands become Treaty Settlement Lands, owned in "fee simple" (outright ownership) by First Nations.
Resources	On Treaty Settlement Lands • Surface and sub-surface resources are owned by First Nations, subject to restrictions. Off Treaty Settlement Lands • Access to forest, plants, and wildlife is defined over claimed territory. • Access to fish for food, social, and ceremonial purposes is defined and protected as a treaty right; participation in commercial fisheries is defined in a separate agreement.
Governance	• The *Indian Act* no longer applies, except for the definition of "Status Indian." • Generally, self-government provisions apply only on Treaty Settlement Lands. • All federal and provincial laws apply, but in a few areas internal to the First Nation community or with respect to the operation of its government, First Nation laws prevail in the event of a conflict. • The *Charter of Rights and Freedoms* continues to apply.
Finances	Funding: • Programs and services to be funded are agreed upon. • First Nations contribute to programs and services using their own revenue sources. • Federal transfers are to be reduced as First Nations become increasingly self-reliant. Taxation: • Exemption from taxation for members of First Nations is abolished after a transition period. • Taxing powers for First Nation governments are to be defined, but exercised concurrently with federal and provincial tax authorities. • Separate tax agreements can be signed to share tax fields.
Financial benefits	• There will be a cash transfer, less loan reimbursement, plus resource revenue sharing and other benefits. The value of land selected is also taken into account. Cash and revenue sharing are provided over a number of years.
Certainty	• A treaty constitutes full and final settlement of all Aboriginal title and rights related to land and resources.

Source: Indian and Northern Affairs Canada

7.21 The objectives of the audit were to determine whether

- the federal government has effective and efficient management procedures and processes, and adequate resources, to achieve its policy objectives through the B.C. treaty negotiation process;
- the federal mandating process ensures that mandates are consistent with applicable authorities; and
- sufficient and appropriate information on the cost and progress of negotiations is being reported to management, the government, and Parliament.

7.22 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

State of negotiations

Negotiations have not yet resulted in a treaty

7.23 In 1991, the federal government expected that all land claims in B.C. would be resolved by the year 2000. At the time of the audit, in 2006, after more than 12 years of negotiations, about $426 million in costs to the federal government, and $289 million in loans to First Nations, the process has not yet produced a treaty. In 1999, a treaty was signed with the Nisga'a Nation in B.C., but this treaty was negotiated outside of the treaty process.

7.24 Federal officials told us that the process should not be judged solely on the number of treaties signed to this point. They stated that many negotiations are advanced and should reach agreement-in-principle and final agreement stages over the next few years. In their view, participation in the negotiation process has also helped build better relations among Canada, B.C., and First Nations and between Canada and B.C. on Aboriginal affairs, and has assisted First Nations in developing expertise in a number of areas, including the management of land and resources. However, there are indications that the failure to deliver treaties, limited interim benefits, and the relatively slow pace of negotiations are actually straining the relations between the governments and First Nations.

7.25 The pace of negotiations can be disrupted by various events. For example, court decisions can slow down negotiations while the impacts of these decisions are analyzed. Elections at the federal, provincial, and First Nations levels can delay decisions or affect negotiation positions.

In addition, some First Nations have withdrawn from group negotiations and have chosen to negotiate on their own. In 2002, B.C. held a province-wide voter referendum to seek support on principles for treaty negotiations.

7.26 The majority of the 47 negotiations (or "tables") in the process are not making steady progress. Documents we reviewed indicate that, in 2005, 12 of the tables were inactive, 17 were challenging, and 18 were productive. The Department's current strategy to achieve treaties is to focus on the negotiation tables that are making progress toward agreements. Two final agreements are seen as imminent, with a third close behind.

There are differing views on the nature of treaties

7.27 There are fundamental differences in views between many First Nations in the B.C. treaty process and the federal government. For example, the federal government does not recognize Aboriginal rights unless they are proven in court. B.C. First Nations consider that Aboriginal rights and title should be acknowledged before negotiations begin. At some negotiation tables, First Nations believe that they are owed compensation for past denial of their rights. The federal government considers that there is no basis to establish such compensation since negotiations are not based on rights. Another critical difference is the federal government's expectation that a treaty constitutes full and final settlement with respect to the Aboriginal rights and title claimed by a First Nation, while many First Nations see treaties as evolving documents recognizing their rights and title. According to the First Nations Summit, the most challenging and fundamental issue in treaty negotiations is "achieving certainty when governments and First Nations hold diametrically opposing views."

The federal government has taken some corrective steps

7.28 The federal government has taken some steps in attempt to accelerate negotiations. For example, in 1999, the federal and provincial governments introduced new programs, such as the Negotiation Preparedness Initiative and Treaty-Related Measures, to support First Nations in negotiations. In addition, over the years, the federal government has approved changes to negotiation mandates and support funding to First Nations in efforts to move discussions along. The federal government has also proposed other measures, such as a minimum level of contribution funding (conditional transfer payment for a specified purpose) regardless of First Nations' size, that

have not been adopted because they lacked the support of one or more parties.

Competing options to the treaty process

First Nations have other legal, political, and economic options

7.29 The legal, political, and economic environments within which treaty negotiations take place have evolved. As a result, there are other options available to all First Nations to pursue their claims, to protect resources, or to provide inputs into decisions regarding resources in claimed areas.

7.30 Legal environment. Federal officials told us that some court decisions have made litigation a more attractive option than treaties, for some First Nations. For example, under specific conditions, First Nations can now access court-ordered funding from the federal or provincial governments to pursue certain Aboriginal rights and title cases. Although litigation has always been available to First Nations as an alternative to negotiations, court-ordered funding may make it less expensive for some First Nations to litigate rather than negotiate since they usually have to borrow money to negotiate treaties.

7.31 Political environment. A significant event involving all B.C. First Nations occurred in March 2005. The First Nations Leadership Council (made up of the political executive of the First Nations Summit, the Union of B.C. Indian Chiefs, and the B.C. Assembly of First Nations) and the B.C. Premier endorsed a document entitled *A New Relationship*. This document outlines how a new government-to-government relationship will be established between the province and B.C. First Nations based on respect, recognition, and accommodation of Aboriginal rights and title. In 2006, the B.C. government committed $100 million to the recently created New Relationship Trust Corporation to help First Nations effectively participate in land and resource management, and in social programs for their communities.

7.32 Economic environment. There are a growing number of contracts involving First Nations inside and outside the treaty process. The federal government, for example, has signed agreements with some First Nations regarding the co-management of, and/or access to, resources in federal parks. First Nations and provincial or municipal governments have signed a number of agreements covering land-use planning, resource development, and/or consultations. In addition, some First Nations have signed partnership agreements with companies wanting to exploit resources in their traditional territory. Many of these arrangements bring "operational" certainty over the

management of land and resources in claimed areas and imply that Aboriginal rights and title exist, without defining them. However, most of these arrangements are short term and of limited scope.

Legal, political, and economic options have consequences for the B.C. treaty process

7.33 Some of the non-treaty options have helped address, albeit temporarily in many cases, some of the issues that the federal government intended to resolve through the treaty process. At the same time, however, they have reduced some First Nations' interest in the treaty process and made it challenging for the governments to offer benefits to First Nations that meet or exceed those available outside the process.

7.34 Federal officials told us that, currently, many of the other options to treaty-making are appealing to First Nations. Some First Nations officials told us that many community members wonder what the benefits are of borrowing money to participate in the treaty process when attractive options are available outside of it.

7.35 In our opinion, given these other options, it will be more difficult under the treaty process as it exists today, for the federal government to achieve its policy objective of signing treaties with most B.C. First Nations.

Policy framework

7.36 We expected that INAC would have in place a policy function and analytic capacity to anticipate challenges and respond strategically. We also expected the Department would have a process to develop policy based on factual analysis and reliable modelling that also considers how policies will be implemented. We also expected that INAC would comply with all applicable authorities and have in place a legal framework of powers, duties, and functions related to treaty negotiations, and a process to identify issues of lawfulness or areas where legal authority may be lacking.

Adjusting federal policies is challenging

7.37 We found that INAC complies with the authorities and policies that apply to the federal participation in the B.C. treaty process. INAC has units in Ottawa and B.C. to develop new policies and guidelines and to revise existing ones. An interdepartmental structure is also in place to coordinate federal policy development in the areas of First Nations land claims and self-government, inside and outside B.C.

However, these structures are complex and make policy development challenging.

7.38 We also found that, despite the challenges, INAC has been able to respond to some policy issues, such as how to ensure a treaty constitutes the full and final settlement of all claimed land rights. INAC, with the cooperation of other departments, has developed new legal techniques and terminology to meet this objective, while considering the reluctance of First Nations to exchange or modify the Aboriginal rights they claim. These changes have allowed some negotiations to continue.

Several issues have not been addressed

7.39 **The Comprehensive Land Claims Policy.** The federal government's participation in the B.C. treaty process is based on its 1986 Comprehensive Land Claims Policy. Although some modifications have been made to the policy, we found no formal analysis to determine how relevant this national policy is to the B.C. treaty negotiations.

7.40 The combination of many factors makes settling land claims in a province like B.C. more challenging than settling land claims in the territories. As in other provinces, most land and resources in B.C. are under the control of the province, not the federal government. Available federal or provincial Crown land is scarce in many areas of B.C., and often is affected by third-party interests. Land generally has a high value, particularly in urban areas. The province is inhabited by a large non-Aboriginal majority with competing interests in the land, fisheries, and other resources that may be offered in treaties. As a result, in some areas of B.C., this limits the governments' ability to develop an offer of resources and benefits acceptable to all parties.

7.41 Under the land claims policy, the federal government considers that Aboriginal rights and title to land remain undefined. However, the nature, scope, and content of Aboriginal rights and title have been made clearer since the policy was established, notably due to decisions of the Supreme Court of Canada. INAC believes that, as a consequence, First Nations in B.C. have higher expectations regarding the way in which their claimed Aboriginal rights and title are dealt with. The Department continues to seek full and final settlement of Aboriginal rights associated with land claims. In response to First Nations' rising expectations, INAC has obtained authority to increase some of the benefits offered to them, which has raised the cost of settling land claims in B.C.

7.42 Negotiating with smaller First Nations. The federal government adopted a policy on the inherent right of Aboriginal self-government in 1995. In this policy, the government stated that the size of the group and economies of scale would be significant factors in determining what is practical to negotiate.

7.43 In the early years of the treaty process, many smaller First Nations were entering into negotiations on their own, as opposed to in larger groups as was initially expected by the parties. Concerns were expressed, notably by the BCTC, about the resources required for negotiating and implementing treaties with smaller First Nations and groups. Initially, INAC addressed only the concerns related to smaller First Nations' negotiation capacities and costs. Some federal recommendations intended to address other challenges associated with negotiating with smaller First Nations were rejected by the other parties on the basis that First Nations were free to organize themselves as they chose for treaty negotiations. It was only when negotiations were more advanced that INAC focused on addressing the federal implementation issues, such as the cost of supporting many small governments and the federal structures required to maintain treaty relations with many smaller First Nations. As many of the most advanced negotiations today are with smaller First Nations, these implementation issues must be addressed.

7.44 Overlapping claims. The large number of claims in B.C. creates many situations where territories claimed by First Nations overlap with each other. This means that the federal government has to deal with all First Nations claiming rights and title to land in a given area before reaching the certainty it is seeking over lands and resources in B.C. Under the B.C. treaty process, overlaps are to be addressed primarily by First Nations. Federal guidelines for settling overlapping claims were developed in 1994, taking into account the situation in B.C. However, due to recent court decisions, the federal government may need to consult with all First Nations that have a claim on an area, whether or not they are in the treaty process, before signing a treaty with a given First Nation. This potential need to consult may add further complexity to the treaty negotiation process where such negotiations have reached the final agreement stage and overlaps are not resolved. In response, INAC has developed a framework for consultations with First Nations regarding overlapping claims in B.C.

7.45 Surplus Crown land. Land potentially available for treaty settlement is scarce in many areas of B.C. As a result, the government's ability and willingness to offer federal Crown land to First Nations can be critical to advancing treaty settlements. In 1998, INAC received

authority and funding to acquire and hold land, including surplus Crown land no longer required by a federal department, for the purpose of eventual treaty settlement.

7.46 Since 1998, INAC has used its authority to acquire 14 properties at a total cost of about $6.9 million. As properties are acquired when they become available and negotiations take a long time, the Department may have to hold the land for many years until a treaty is signed and the land formally transferred to a First Nation. At the time of the audit, the total cost to INAC of holding these 14 properties was about $1.7 million and the eventual transfer of these properties to First Nations was still a few years away.

7.47 We found that some practices to dispose of surplus Crown land can be at odds with the objective of signing treaties in areas where land is scarce and valuable. When it comes to disposing of federal properties of high value and importance, INAC has no higher a priority than other departments to acquire surplus land. The procedures and time frames associated with disposals are also difficult to coordinate with those in the treaty process. For example, under existing practices, surplus Crown land cannot be acquired by INAC for treaty settlement purposes unless a First Nation has signed a negotiation framework agreement. In one case we examined, negotiations with a First Nation had not reached that stage, and the Department could not acquire a piece of Crown land that became available in the Vancouver area. The First Nation obtained a temporary court injunction to stop the sale of the property. Eventually, a solution was found, but it did not support treaty negotiations nor help resolve the First Nation's outstanding claim.

7.48 **Case law.** Since 1982, approximately 40 Supreme Court of Canada decisions have provided guidance on the nature and content of Aboriginal rights, including Aboriginal title to land, and on the Crown's obligations with respect to such rights. Certain decisions, such as *Delgamuukw* in 1997 and *Haida* and *Taku River* in 2004, have created challenges for various federal policies and practices, and for the treaty process as a whole. We found that INAC has identified risks and potential consequences, and made changes to some policies and practices. However, development of policies that respond to these court decisions is slow.

7.49 Our reading of some key court decisions found that the courts may now interpret treaty negotiations as a "reconciliation" process in which rights of First Nations are implicitly recognized since negotiations on those rights are taking place. This may be inconsistent

with the federal government's position that treaty negotiations are essentially based on policy and conducted "without prejudice" (the discussions cannot be used in court), and that it does not recognize rights until a final agreement is ratified. Nonetheless, courts strongly support negotiations as the preferred means of reconciling governments' and First Nations' interests.

7.50 Duty to consult. The Supreme Court of Canada, in *Sparrow* (1990) and *Delgamuukw* (1997), stated that governments have a duty to consult First Nations as part of the process of justification for infringements of proven Aboriginal rights or title. In 2004, the Supreme Court of Canada stated for the first time, in *Haida* and *Taku River*, that governments also have a duty to consult and where appropriate, accommodate First Nations when the governments have knowledge of the potential existence of an Aboriginal right or title, and are considering taking actions that might adversely affect it. Although work has started on how the federal government intends to fulfill this duty, no formal mechanism is yet in place.

7.51 Reviewing policy objectives. INAC acknowledges that a more timely and coordinated process for ongoing policy development and review is required.

7.52 Recommendation. Indian and Northern Affairs Canada, in collaboration with other relevant federal departments and agencies, should develop a more expeditious and coordinated process for ongoing policy development and review related to its participation in B.C. treaty negotiations. This ongoing federal policy review process should take into account

- lessons learned from its participation in the B.C. treaty process,
- case law on Aboriginal rights and title,
- the existence of other options available to First Nations, and
- the federal government's objectives and priorities.

Department's response. Indian and Northern Affairs Canada will work with its federal partners to improve existing internal federal processes with respect to policy development, in order to respond more effectively to policy-related challenges and opportunities at the treaty tables. Policy development will continue to be informed by individual treaty negotiations and evolving case law. The federal government will explore with B.C. and the First Nations Summit how the tripartite "principals' process," created for political and working-group level

discussion about policy and process issues affecting the B.C. treaty process, might be made more effective.

7.53 Recommendation. Indian and Northern Affairs Canada, in cooperation with other relevant federal departments and agencies, and in consultation with First Nations, should develop a policy to fulfill the federal government's duty to consult and, where appropriate, accommodate First Nations, as set out in Supreme Court of Canada decisions.

Department's response. Indian and Northern Affairs Canada will continue work already underway with respect to consultation. In response to the Supreme Court of Canada's 2004 *Haida* and *Taku River* decisions, INAC and other federal departments are developing a federal approach on consultation and accommodation that could be applied consistently across regions and increase the level of interdepartmental coordination. Preparatory discussions have been held with representatives of First Nations, Inuit, and Métis groups and with provincial/territorial officials regarding the scope and content of the approach and how these groups wish to be engaged.

Negotiation process

Negotiating strategic outcomes is difficult

7.54 We expected that INAC would have clearly defined measurable strategic outcomes reflecting its mandate and strategic vision, and that clear results statements would be in place.

7.55 We found that INAC has a vision of the specific outcomes it wants to achieve from treaty negotiations and of the federal government relations with First Nations once treaties are in place. For example, it has developed position papers on key negotiation topics such as lands and resources. These positions were tabled in writing, or presented orally, at most of the negotiation tables we reviewed.

7.56 We also found, however, that some of the positions outlined in these papers are complex and difficult to negotiate. For example, the federal government expects that, under treaties, First Nations will contribute a share of revenues from their own activities to cover the costs of their programs and services. Some First Nations agree with this principle. The federal government has developed guidelines on the use of First Nations' own revenues and provided specific information on the federal position to certain First Nations. However, officials told us that they are having difficulty negotiating with First Nations how the federal proposition will be implemented. Work is underway in an attempt to resolve philosophical and practical issues.

7.57 We also found that departments and agencies supporting INAC in treaty negotiations do not always provide timely responses about their treaty positions to INAC.

7.58 Further, tensions may arise between the need to sign treaties and the government's responsibility to consider other interests. For example, INAC must negotiate the fisheries provisions in treaties with First Nations, who can have strongly held positions on what they are prepared to accept. Fisheries and Oceans Canada must consider the interests of a number of stakeholders not involved in the treaty process (such as commercial and recreational fishers) with the objective of signing treaties. Fisheries and Oceans Canada believes that it must do this while maintaining ministerial discretion to manage and protect fish and fish habitat. INAC and Fisheries and Oceans Canada are required to reconcile these broader government objectives before the fisheries provisions of a treaty can be finalized.

7.59 The process of seeking a specific mandate (the federal government's detailed instructions for each treaty) or revisions to a mandate is lengthy, which can slow the pace of negotiations with First Nations. A fair amount of federal negotiating resources and time are spent trying to resolve internal differences within the federal government.

7.60 According to some officials, treaty negotiations are one of the most controlled and inflexible processes in the federal government, involving approximately 40 departments and agencies, including central agencies, and a coordination structure to manage different levels of approvals. Consequently, this process can only take small steps at a time. We were also told that while the various federal departments involved in mandate decisions may be willing to consider changes, supporting treaty negotiations may not be a priority for them. Other officials observed that this process is structured as if the main risk faced by the federal government in treaty negotiations is that of deviating from existing mandates, rather than that of not signing treaties.

Time and resources are not adequately managed

7.61 We expected that INAC would ensure that management structures and practices are in place, with adequate resources, to support timely negotiations of treaties. We also expected that INAC would have processes to gather relevant information on results and use it to make decisions.

7.62 We found that a negotiation management structure and negotiation practices are in place within INAC. However, the Department has not conducted the necessary analyses to be able to estimate the amount of time and resources required to negotiate individual treaties. In addition, the Department does not know whether the resources invested so far are in line with progress to date.

7.63 We also found that INAC gives limited attention to negotiation time frames. Nearly a third of the negotiation framework agreements signed by the Department do not identify a time frame for reaching an agreement-in-principle. For those that do, we found limited or no analysis by INAC before or during negotiations of the time or resources required by the Department and the federal government to meet the time frames. For example, in many framework agreements that did have a time frame, the parties agreed to attempt to complete an agreement-in-principle within two years. Although these framework agreements were signed by the Minister of INAC on behalf of Canada, we did not see any analysis of the Department's ability to meet the time frame set in each case.

7.64 For the framework agreements with set time frames for reaching agreements-in-principle, we found that all but one of the target dates have been missed. However, for the one target date that has not been missed, we were informed that it is unlikely to be met because these negotiations are inactive. The time frames set at the final agreement stage are also being missed. For example, both final agreement negotiation tables that we reviewed have already taken twice as long as their initial estimates and are over a year behind their original target dates for concluding a final agreement.

7.65 INAC officials told us that treaty negotiations are dynamic and that negotiators must remain flexible in order to deal with unforeseeable issues, many of which are outside INAC's direct sphere of influence. For example, some agreements-in-principle have been rejected by First Nations' members and some First Nations have withdrawn from the treaty process. According to these officials, it is impossible to manage treaty negotiations with the same level of planning and oversight as a construction project, for example. They state that they monitor progress in drafting the various chapters of a treaty and list issues to be resolved because these are tools more appropriate to this type of process.

7.66 We found that INAC is making some efforts to manage time and resources. For example, some negotiation teams have developed tripartite work plans. However, with few exceptions, the plans we

reviewed were in draft form, and essentially listed outstanding topics and calendar days on which these would be discussed. They covered periods of less than one year and contained no estimates of the time or resources needed to complete the tasks leading to an agreement-in-principle or final agreement.

7.67 INAC states that, since 2002, it has promoted results-based negotiations that focus on achieving agreements. To that end, the Department introduced an annual assessment of each negotiation table. The assessments are to identify those negotiations that are productive, challenging, or inactive; to suggest steps to improve productivity; and to allocate resources. The information provided allows the Minister of INAC to decide whether to disengage from some negotiation tables. These assessments are an improvement.

7.68 **There are no official targets.** Despite these activities, we did not find any reliable estimates as to when INAC believes negotiations with all First Nations and groups currently in the treaty process will be completed, and at what cost. In addition, there is no formal estimate of what results will be achieved in the short term. Unlike INAC's previous submissions to the Treasury Board, its most recent submission seeking a financial authority for the period 2004–2009 contained no reference to a projected number of agreements.

7.69 INAC internal documents, however, indicate that between June 2006 and March 2009, the Department expects to conclude 19 agreements-in-principle and three final agreements.

7.70 **First Nations debts.** One significant impact of longer than initially anticipated negotiation time frames is the higher debt load of First Nations. Negotiation loans are deemed by the federal government to be advances on an eventual treaty settlement and are recoverable through the cash portion of the settlement. As negotiations take more time, First Nations need to borrow additional funds to cover their costs and, therefore, the net value of their potential benefits is being reduced. The Department acknowledges that this problem is compounded by the fact that some negotiation costs are the same, regardless of First Nation size, while the amount of cash offered to smaller First Nations is lower.

7.71 Partly in response to the growing First Nations debt load, INAC sought and obtained changes to the loan program in 2002. For example, if negotiations are progressing, the date when loans become due and payable can be extended from 12 to 17 years after negotiations began. In addition, INAC will pay the interest charges on all loans,

including those taken by First Nations in final agreement negotiations, until 31 March 2009. In our view, these changes do little to keep negotiation costs down or to substantially limit the growth of First Nations debt.

7.72 High debt levels create challenges for concluding agreements. For some smaller First Nations, we estimated that outstanding loans relative to the cash offered at the agreement-in-principle stage range from 44 percent to 64 percent. In one of these cases, a First Nation was unwilling to borrow more money, so the Department found another program whose terms and conditions were such that the First Nation was able to apply for and receive $600,000 to carry on treaty negotiations.

7.73 Finally, we found that INAC has continued to absorb the interest charges on the loans of three First Nations that withdrew from the treaty process. These loans amount to over $7 million. Although the due date to repay the loans is nearing, the Department has not yet determined what course of action it will take.

Managing human resources is becoming a challenge

7.74 We expected that INAC would have in place a comprehensive human resources plan aligned with the Department's strategic outcomes. We limited our examination of this issue to the FTNO. We found that it has a human resources plan. The plan identifies some positions that are critical to meet the FTNO's goals and, where relevant, the actions that need to be taken to fill these positions. The FTNO believes that until recently, it had sufficient staff to meet the demand associated with treaty negotiations. However, the FTNO acknowledges that it will have to more carefully manage its human resources in the future in order to meet the expected growth in workload if the number of negotiation tables in the final agreement stage increases.

7.75 Recommendation. Indian and Northern Affairs Canada should improve its management of treaty negotiations by better defining the results to be achieved at each table, and the time and resources required, including those of First Nations, to achieve these results.

Department's response. Indian and Northern Affairs Canada will explore opportunities to improve its time and resource management, with particular attention to targeted deadlines and results. The Department will place greater emphasis on results-based negotiations,

focusing its efforts on negotiation tables where progress is demonstrably possible.

INAC's success in meeting some of these commitments requires the involvement of the other participants in the B.C. treaty process. A more effectively managed treaty process is in all the parties' best interests, enabling First Nations and governments to achieve their objectives more quickly and economically.

Reporting to Parliament

Parliament is not adequately informed

7.76 We expected that INAC's reporting on B.C. treaty negotiations would be balanced, transparent, and easy to understand. Parliament receives information on the B.C. treaty process mostly through INAC's report on plans and priorities and through its departmental performance report. BCTC annual reports are also tabled in Parliament; however, we did not audit them.

7.77 We found that Parliament is not adequately informed by INAC about the federal costs and progress of the B.C. treaty process. We found that the information provided to Parliament on results achieved and on the obstacles and impediments to progress in treaty negotiations in B.C. is not balanced, transparent, or easy to understand.

7.78 For example, progress toward key milestones is reported for some negotiation tables; however, the fact that many negotiation tables are inactive is not reported, leading readers to understand that negotiations are continuing at all tables. Although some reports contain information on various obstacles to progress in negotiations, there is limited information on their impacts on achieving expected results and on how they influence expectations. Expected results are not always defined, and when they are, achievements are not compared with expectations. This makes it difficult to assess performance.

7.79 Considering the importance that Canada has placed on the B.C. treaty process and the significant amount of funding that Parliament has been asked to approve, clearer reporting is needed.

7.80 Recommendation. Indian and Northern Affairs Canada should report to Parliament clearer information on the results expected by the federal government with time frames, the results achieved, the extent of First Nations' participation, and the costs involved. When results are lower than expected, explanations should be provided along with any adjustments to expectations, where relevant.

Department's response. Although current reporting systems comply with existing federal government statutory requirements and the BCTC's Annual Reports, which are tabled each fall in Parliament, are a good source of information, the Department agrees that the importance and cost of the B.C. treaty process warrant more accessible and comprehensive reporting to Parliament, and will explore ways to make improvements.

Conclusion

7.81 The procedures and processes in place to manage the federal participation in the B.C. treaty process are not adequate to allow Indian and Northern Affairs Canada to estimate the time and resources required to effectively and efficiently carry out negotiations. The resources invested so far in the B.C. treaty process, and associated procedures and processes, have not achieved the government's key policy objectives and no treaties have been signed. In addition, several issues that limit progress in negotiations have not been addressed.

7.82 The federal treaty mandating process ensures that mandates are consistent with applicable authorities. However, the mandating process is complex and internal differences between federal departments over some aspects of mandates can slow the pace of negotiations with First Nations. Moreover, there may be inconsistencies between case law and the federal government's position on the political nature of treaty negotiations.

7.83 Sufficient and appropriate information on the cost and progress of negotiations is not being reported to management or the government. Parliament is not adequately informed about the results of Canada's participation in the B.C. treaty process.

Department's overall response. Indian and Northern Affairs Canada accepts and will act on all four of the Auditor General's recommendations related to policy, consultation and accommodation, process management, and reporting structures. In so doing, the Department anticipates making the British Columbia treaty process better—a process that, despite the challenges, has made tangible progress and is likely to produce, in the near future, a number of final agreements. To quote the Auditor General's report, "Settling the uncertainty associated with unresolved land claims in British Columbia is important for all Canadians."

The negotiations have turned out to be more complex and time-consuming, and to involve more individual treaty tables and difficult issues, than was predicted by any of the parties when negotiations began. Nonetheless, as the Supreme Court has repeatedly stated, governments are obligated to reconcile Crown sovereignty with pre-existing Aboriginal title. The Court has endorsed treaty negotiations as a means of achieving this reconciliation.

Litigation can only partially resolve outstanding issues regarding Aboriginal rights and title. Sectoral agreements with First Nations are positive developments, but not a substitute for comprehensive treaties analogous to those that have been successfully reached in other parts of Canada. Treaties are more difficult to achieve, but the negotiation process in British Columbia has itself already accomplished a great deal in terms of capacity building, reducing conflict and potential litigation, increasing British Columbians' understanding of First Nations' issues, and forging new relationships and partnerships.

As one of three parties in a voluntary process of negotiation, the federal government cannot guarantee the outcomes at individual treaty tables. However, several final agreements and agreements-in-principle are within reach in the near future. This prospect of success is also creating momentum at other tables.

About the Audit

Objectives

The objectives of the audit were to determine whether

- the federal government has effective and efficient management procedures and processes, and adequate resources, to achieve its policy objectives through the B.C. treaty negotiation process;
- the federal mandating process ensures that mandates are consistent with applicable authorities; and
- sufficient and appropriate information on the cost and progress of negotiations is being reported to management, the government, and Parliament.

Scope, approach, and criteria

Indian and Northern Affairs Canada (INAC) is in charge of the federal government's participation in British Columbia treaty negotiations with First Nations and the Province of British Columbia (B.C.).

The audit covered primarily the management procedures and processes and the resources used by the federal government in treaty negotiations in B.C. Our audit focused on the activities of INAC related to these treaty negotiations, and the results of those activities. It also included, where relevant, the support provided to INAC by other federal departments involved in the process.

The audit team carried out interviews with departmental managers and staff, including federal negotiating teams, and reviewed relevant documents at INAC B.C. Region, including the Federal Treaty Negotiation Office (FTNO), and at headquarters. The audit team carried out additional interviews with officials at central agencies, Fisheries and Oceans Canada, and the Department of Justice Canada. We also reviewed federal negotiation files and related documents for 12 negotiation tables in the B.C. treaty process. We looked at the policy development and mandating processes within INAC. Although we did not audit the activities carried out by First Nations and their organizations, we sought their views on matters related to the B.C. treaty process. The team also visited two First Nations communities. These visits included discussions with political leaders and negotiators. We also sought the views of the First Nations Summit and the Union of B.C. Indian Chiefs and interviewed commissioners of the British Columbia Treaty Commission (BCTC).

We expected to find that

- INAC complies with all applicable authorities and has in place a legal framework of powers, duties, and functions related to treaty negotiations and a corporate process to identify issues of lawfulness and areas where legal authority may be lacking;
- INAC has in place a strategic policy function and analytic capacity to anticipate challenges and respond in a strategic manner, and a policy development process grounded in fact-based analysis with reliable modelling and due regard to implementation and operational matters;
- INAC ensures that management structures and practices are in place to support timely negotiations of treaties;

- INAC has in place clearly defined, measurable strategic outcomes that reflect FTNO/INAC's mandate and strategic vision, and clear results outcome statements that are linked to this government-wide priority;
- INAC has adequate resources to support timely negotiations of treaties;
- INAC has in place a comprehensive human resources plan aligned with the organization's strategic outcomes;
- INAC gathers relevant information on results and uses it to make departmental decisions; and that
- INAC has in place balanced, transparent, and easy-to-understand public reporting.

Audit work completed

Audit work for this chapter was substantially completed on 9 June 2006.

Related audit work

Follow-up of Recommendations in Previous Reports (December 2001 Report of the Auditor General, Chapter 12); see the section titled Indian and Northern Affairs Canada—Comprehensive Land Claims (September 1998 Report of the Auditor General, Chapter 14). See also the original report, Indian and Northern Affairs Canada—Comprehensive Land Claims (September 1998 Report of the Auditor General, Chapter 14).

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 7. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Department's response
Policy Framework	
7.52 Indian and Northern Affairs Canada, in collaboration with other relevant federal departments and agencies, should, without delay, develop a more expeditious and coordinated process for ongoing policy development and review related to its participation in B.C. treaty negotiations. This ongoing federal policy review process should take into account • lessons learned from its participation in the B.C. treaty process, • case law on Aboriginal rights and title, • the existence of other options available to First Nations, and • the federal government's objectives and priorities. **(7.36–7.51)**	Indian and Northern Affairs Canada will work with its federal partners to improve existing internal federal processes with respect to policy development, in order to respond more effectively to policy-related challenges and opportunities at the treaty tables. Policy development will continue to be informed by individual treaty negotiations and evolving case law. The federal government will explore with B.C. and the First Nations Summit how the tripartite "principals' process," created for political and working-group level discussion about policy and process issues affecting the B.C. treaty process, might be made more effective.
7.53 Indian and Northern Affairs Canada, in cooperation with other relevant federal departments and agencies, and in consultation with First Nations, should develop a policy to fulfill the federal government's duty to consult and, where appropriate, accommodate First Nations, as set out in Supreme Court of Canada decisions. **(7.50)**	Indian and Northern Affairs Canada will continue work already underway with respect to consultation. In response to the Supreme Court of Canada's 2004 *Haida* and *Taku River* decisions, INAC and other federal departments are developing a federal approach on consultation and accommodation that could be applied consistently across regions and increase the level of interdepartmental coordination. Preparatory discussions have been held with representatives of First Nations, Inuit, and Métis groups and with provincial/territorial officials regarding the scope and content of the approach and how these groups wish to be engaged.

Recommendation	Department's response
Negotiation Process	
7.75 Indian and Northern Affairs Canada should improve its management of treaty negotiations by better defining the results to be achieved at each table, and the time and resources required, including those of First Nations, to achieve these results. **(7.54–7.74)**	Indian and Northern Affairs Canada will explore opportunities to improve its time and resource management, with particular attention to targeted deadlines and results. The Department will place greater emphasis on results-based negotiations, focusing its efforts on negotiation tables where progress is demonstrably possible. INAC's success in meeting some of these commitments requires the involvement of the other participants in the B.C. treaty process. A more effectively managed treaty process is in all the parties' best interests, enabling First Nations and governments to achieve their objectives more quickly and economically.
Reporting to Parliament	
7.80 Indian and Northern Affairs Canada should report to Parliament clearer information on the results expected by the federal government with time frames, the results achieved, the extent of First Nations' participation, and the costs involved. When results are lower than expected, explanations should be provided along with any adjustments to expectations, where relevant. **(7.76–7.79)**	Although current reporting systems comply with existing federal government statutory requirements and the BCTC's Annual Reports, which are tabled each fall in Parliament, are a good source of information, the Department agrees that the importance and cost of the B.C. treaty process warrant more accessible and comprehensive reporting to Parliament, and will explore ways to make improvements.

Department's overall response

Indian and Northern Affairs Canada accepts and will act on all four of the Auditor General's recommendations related to policy, consultation and accommodation, process management, and reporting structures. In so doing, the Department anticipates making the British Columbia treaty process better—a process that, despite the challenges, has made tangible progress and is likely to produce, in the near future, a number of final agreements. To quote the Auditor General's report, "Settling the uncertainty associated with unresolved land claims in British Columbia is important for all Canadians."

The negotiations have turned out to be more complex and time-consuming, and to involve more individual treaty tables and difficult issues, than was predicted by any of the parties when negotiations began. Nonetheless, as the Supreme Court has repeatedly stated, governments are obligated to reconcile Crown sovereignty with pre-existing Aboriginal title. The Court has endorsed treaty negotiations as a means of achieving this reconciliation.

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Report of the Auditor General of Canada to the House of Commons—November 2006

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Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Chapter 8

Allocating Funds to Regulatory Programs—Health Canada

Office of the Auditor General of Canada



2006



Report of the

Auditor General of Canada

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Chapter 8

Allocating Funds to Regulatory Programs—
Health Canada

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.



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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-8E
ISBN 0-662-44372-1

Chapter

8

Allocating Funds to Regulatory Programs

Health Canada

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Allocating Funds to Regulatory Programs
Health Canada

Main Points

What we examined

Health Canada is responsible for regulating the safety and use of a wide range of items that Canadians commonly use. We examined both the process by which Health Canada decides what resources to allocate to each of its branches and the information used as the basis for resource allocation. We looked in particular at how branches allocate resources to three regulatory programs: product safety, drug products, and medical devices. We examined the impact of the Department's resource allocation process on its ability to carry out its regulatory responsibilities in these areas. The audit focused on fiscal years 2003–04 and 2004–05.

Why it's important

When Canadians use products regulated by Health Canada—whether household products such as cribs, medical devices such as blood test kits, or prescription drugs—they expect that as long as they follow directions, the product will be safe to use. Programs that regulate these products need enough resources to ensure that Canadians are adequately protected from risks to their health and safety. Health Canada, as a regulator, needs to be able to demonstrate that it is fully meeting its regulatory responsibilities.

What we found

- Program managers have indicated to branch management that some core compliance and enforcement activities are insufficient to protect Canadians' health and safety. While the total funding allocated to two of the three audited programs has remained constant, all three programs audited received less funding for core activities in 2005–06 than in 2003–04. Meanwhile, the complexity of programs and the growing demands on programs could significantly affect Health Canada's ability to meet its regulatory responsibilities.
- Health Canada has not set performance targets for all of the compliance and enforcement activities of the programs we audited. It has not determined the level of activities the programs must carry out to meet the Department's regulatory responsibilities, or the level of resources they would need to do so. Therefore, it does not know if it is fully meeting its responsibilities as the regulator of drug products, medical devices, and product safety.

- Program managers do not always have complete information to decide on how best to allocate their resources. There is limited information on the required level of program performance and the funding needed for the programs to meet its legislative requirements. There is also limited information on the results achieved for the funding received by the programs. This makes it difficult for program managers to determine the level of funding each activity needs if it is to provide Canadians with the appropriate level of protection.
- In the absence of a baseline, program managers use their experience and knowledge of their programs to report to branch management on funding shortfalls and unfulfilled regulatory responsibilities. Furthermore, the Departmental Executive Committee does not routinely receive information on how well Health Canada is fulfilling its core role as regulator, even though the Committee is the only group in Health Canada that can address cross-branch funding issues.
- Health Canada is taking steps to improve its resource allocation process. The Department has redesigned the operational planning process that will be implemented in 2006–07. This is intended to standardize the process, document decisions, and communicate to senior management the expected results based on the funding approved.

Health Canada has responded. Health Canada agrees with our recommendations. Its detailed responses follow the recommendations throughout the chapter.

Introduction

Importance of regulatory programs in Health Canada

8.1 One of Health Canada's core roles is that of regulator, according to the *Department of Health Act*. As such, the Department carries out legislative and statutory activities to protect Canadians' health and safety and ensure that products vital to their health and well-being are provided.

8.2 The Department has regulatory responsibilities for thousands of products. These include pesticides, toxic substances, pharmaceuticals, biologics, medical devices, natural health products, consumer goods, and foods. Health Canada delivers a range of programs and services in environmental health protection, and has responsibilities in the areas of substance abuse, tobacco policy, workplace health, and the use of consumer products.

8.3 Regulatory programs for which Health Canada has primary responsibility play an important part in furthering public health and safety. Accordingly, it is critical that the Department adequately fund these programs to fulfill its responsibilities. In essence, Health Canada, as a regulator, needs to have adequate resources to fulfill its obligations, which include monitoring compliance with the regulations and enforcing them as necessary.

Need for a sound financial resource allocation process

8.4 For Health Canada, to make responsible spending decisions related to the delivery of programs and services, the Department needs an effective resource allocation process. As part of this process, the Department needs to decide what it is trying to achieve, what its priorities are, and direct resources toward programs and services that help Canadians. It then needs to monitor its programs to ensure that they are achieving the intended results. Therefore, to make these important decisions, Health Canada requires sound financial and performance information that must include the cost to achieve the stated objectives. It also needs to be able to link financial and performance information to determine results achieved with the funding received.

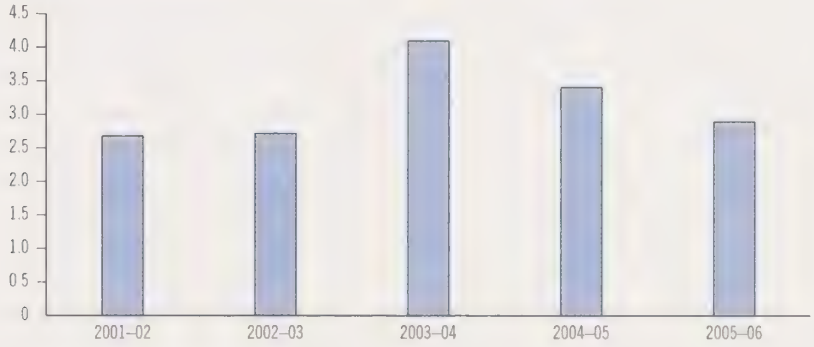
8.5 Health Canada spent $3 billion in 2005–06 on helping Canadians maintain and improve their health. The Department needs to have a sound resource allocation process to ensure that funds are spent where they will do the most good. Exhibit 8.1 shows the

Department's total spending over five years. The increased spending in 2003–04 was due to payments of large grants to organizations and to address the emergence of bovine spongiform encephalopathy (BSE), severe acute respiratory syndrome (SARS), and West Nile virus. The decreased spending in 2005–06 was due in part to Health Canada transferring some of its resources to the newly created Public Health Agency of Canada as of 1 April 2005, and to the Department's contribution to government-wide cost reductions.

8.6 The primary source of funding for the regulatory programs is core funding, which represents funds that are provided to Health Canada to support ongoing programs. The Minister of Health may also seek approval from Cabinet and the Treasury Board to carry out a special initiative that the Department would otherwise be unable to undertake. Additional funding may be required to carry out such initiatives. This report refers to this secondary source of funding as funding for special initiatives. Both core funding and funding for special initiatives require parliamentary approval through the Estimates.

8.7 A third source of funding is revenue, which consists of fees that Health Canada collects from industry for services provided to it such as reviews of submissions for new drugs. Health Canada has the authority to use its revenue from fees to finance the service from which they are generated. A regulatory program can also receive funds through internal reallocations, which refers to taking funds from one program or activity and reallocating them to another program or activity (see 8.48 to 8.51).

Exhibit 8.1 Health Canada's spending from 2001–02 to 2005–06 ($ billions)



Source: Public Accounts of Canada

Focus of the audit

8.8 Our audit focused on whether Health Canada allocates financial resources according to plans based on sound financial and performance information. We also wanted to determine whether program managers regularly report relevant information on sources of funding, program costs, and results at all levels of the organization and whether this information is used to allocate resources. Finally, we wanted to know whether Health Canada can demonstrate that it allocates adequate funds to regulatory programs to ensure that they can meet the Department's regulatory responsibilities.

8.9 Since most of the regulatory programs at Health Canada are found in two branches, we focused our work in these units: the Healthy Environments and Consumer Safety Branch (HECSB) and the Health Products and Food Branch (HPFB), which had a budget of $226.5 million and $239 million respectively in 2004–05. Within these two units, we examined three regulatory programs. In HECSB, we selected the Product Safety program because it had the most acts and regulations under its responsibility. In HPFB, we selected the Drug Products and Medical Devices programs because of the importance of their budgets, their large cost-recovery component, and the increased funding the programs received through special initiatives. Exhibit 8.2 describes the three regulatory programs audited.

Examples of drug products—Prescription drugs and non-prescription products such as sunscreens.

Examples of medical devices—Pacemaker, scalpel, contact lenses, orthopaedic implants, and diagnostic ultrasound systems.

8.10 We examined how resources are allocated to programs and directorates within each branch. Specifically, we examined their plans, budgets, resource allocation, and decision making. We also looked at reporting by the programs and directorates to senior management on program costs and results.

8.11 Exhibit 8.3 shows the three programs audited within the two branches.

8.12 Our audit focused on the process by which Health Canada decides what resources to allocate to each of its branches and programs and the information on which it bases those decisions. We have not audited the efficiency of the three selected programs.

8.13 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Exhibit 8.2 **Regulatory programs audited**

Product Safety. The mandate of the Product Safety program is to identify, assess, and manage the health and safety risks to Canadians associated with

- consumer products,
- hazardous workplace materials,
- cosmetics,
- new chemical substances,
- products of biotechnology,
- radiation produced by radiation-emitting devices,
- environmental noise, and
- solar UV radiation.

The program has responsibilities under several acts and regulations, including the *Hazardous Products Act*, and had a budget of $17.8 million in 2003–04 and $18.7 million in 2004–05.

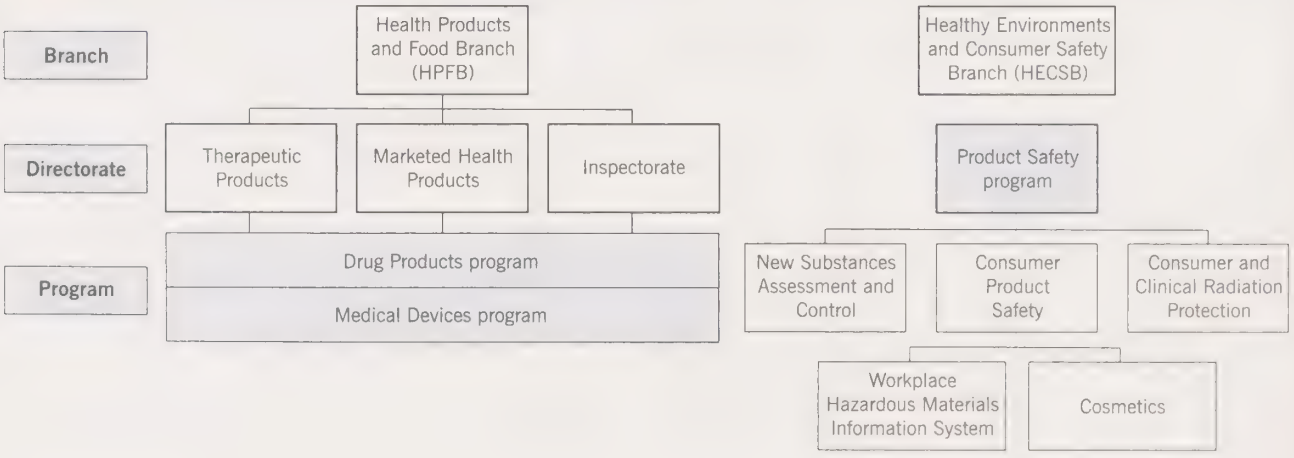
Drug Products. According to Health Canada, the Drug Products program maximizes the safety of marketed human drug products through its regulations. The program is delivered by three directorates in the HPFB (Exhibit 8.3).

- The Therapeutic Products Directorate provides pre-market approval of pharmaceutical drugs offered for sale in Canada, ensuring that they are safe, effective, and of high quality.
- The Marketed Health Products Directorate conducts post-market surveillance of prescription and over-the-counter drugs and other health products for their safety and therapeutic effectiveness.
- The HPFB Inspectorate delivers a national compliance and enforcement program such, as inspections of manufacturers and product investigations for all health products under the Branch's mandate, including drugs for humans.

The Drug Products program had a budget of $51.8 million in 2003–04 and $50.6 million in 2004–05.

Medical Devices. The goal of the Medical Devices program is to ensure, to the extent possible, that the public has timely access to safe, effective, and quality devices. It also contributes to the continued protection of the public by informing health professionals and the public of any safety concerns on a timely basis. Like the Drug Products program, the Medical Devices program is delivered jointly by the Therapeutic Products Directorate, the Marketed Health Products Directorate, and the HPFB Inspectorate, which apply the *Medical Devices Regulations*. The program budget was $8.8 million in 2003–04 and $11.4 million in 2004–05.

Exhibit 8.3 **The three audited programs within the Health Products and Food Branch and the Healthy Environments and Consumer Safety Branch**



Source: Health Canada

Observations and Recommendations

Meeting regulatory responsibilities

8.14 For drug products, medical devices, and product safety, Health Canada has a legislated responsibility that is outlined in the *Food and Drugs Act*, *Hazardous Products Act*, *Radiation Emitting Devices Act*, *Canadian Environmental Protection Act*, and related regulations. As a regulator, Health Canada carries out activities to ensure that regulations are complied with and, if not, that enforcement actions are taken. In delivering on these responsibilities, Health Canada helps ensure that the public has access to safe and effective drugs, medical devices, and consumer products. It also helps ensure the public's continued protection by informing health care professionals and the public of any safety concerns on a timely basis and ensuring that products on the market are safe.

8.15 The Department carries out pre-market and post-market regulatory activities. Pre-market activities are conducted before authorizing a company to market a product. These activities include authorizing clinical trials for drug products, authorizing investigational testing (clinical trials) for medical devices, and reviewing submissions of scientific evidence by manufacturers to determine a product's safety, quality, and efficacy before authorizing it for market. Surveillance and post-market activities are conducted after manufacturers are authorized to market drugs and medical devices. Activities focus on product safety and effectiveness, and regulatory compliance. For unapproved products, other compliance and enforcement activities are carried out, such as stopping sales and making recalls.

Health Canada does not know whether regulatory responsibilities are fully met

8.16 According to the government's *Regulatory Policy*, departments must ensure that enough resources have been approved to effectively discharge enforcement responsibilities and to ensure compliance with the regulations. We therefore expected Health Canada program managers to know the required level of funding needed to carry out their regulatory responsibilities.

8.17 We examined a number of documents, such as program policies, operational plans, mid-year reports, programs' Results-based Management and Accountability Frameworks where they existed, and documents providing the rationale for proposing and amending the regulations, for evidence of **program baselines**. We found that some directorates have components of a program baseline. For example, performance targets have been developed for some of their activities

Program baseline—The required level of activities that a program must carry out in order to meet its regulatory responsibilities of protecting the health and safety of Canadians, the targeted performance for these activities, and the resources needed to do this work.

(such as review times for drug products and medical devices submissions, and the frequency of inspections). However, none of the directorates had all of the elements of a baseline that could have been used for planning, resource allocation, and accountability.

8.18 Without defining the program baseline, Health Canada cannot demonstrate that it has allocated enough resources to the three programs audited to meet its regulatory responsibilities.

Program managers are concerned that some regulatory activities are insufficient

8.19 Program managers indicated to their branch management that insufficient compliance and enforcement activities were carried out. Without a program baseline, they used their experience and knowledge of the program to arrive at this conclusion. Program managers have also indicated that they use a risk-based approach to minimize the health risks to Canadians.

8.20 The Product Safety program is responsible for five commodity areas:

- consumer product safety (for example, cribs, tents, carpets);
- cosmetics (for example, deodorants, soaps);
- workplace hazardous materials information systems (for example, communication of information on corrosive material);
- consumer and clinical radiation protection (for example, x-rays, lasers, sunlamps); and
- new substances (for example, fabric dyes, fuel additives).

8.21 Product Safety program managers considered many of their regulatory activities to be insufficient to meet their regulatory responsibilities. We found these opinions were confirmed in an internal study of the program's resource needs, documents relating to resource allocation, and in interviews conducted as part of our audit (Exhibit 8.4).

8.22 The Product Safety program has requested additional funding, but it received very little funds for special initiatives in 2005–06 to address the shortfalls presented above. Program managers indicated that their inability to carry out these responsibilities could have consequences for the health and safety of Canadians, such as exposure by consumers to non-compliant hazardous products. There is also a risk of liability to the Crown.

8.23 Program managers for Drug Products and Medical Devices also indicated in an internal study and in interviews that they consider the level of some post-market compliance and enforcement activities to be insufficient to meet their regulatory responsibilities (Exhibit 8.5).

8.24 Drug Products and Medical Devices programs were successful in getting some additional funding for special initiatives. According to program managers, this allowed them to eliminate the backlog of submissions made by manufacturers seeking review and authorization to market a product. However, they considered the additional funding to be insufficient to address all the shortfalls identified in Exhibit 8.5.

8.25 According to program managers, failure to carry out these responsibilities could have consequences for the health and safety of Canadians, such as exposure to unsafe, ineffective, or dangerous therapeutic products. There is also an increased risk of liability to the Crown.

Exhibit 8.4 Examples of regulatory activities considered by Product Safety program managers to be insufficient

	Product Safety				
Regulatory activities	**Consumer Product Safety**	**Cosmetics**	**Workplace Hazardous Materials Information Systems**	**Consumer and Clinical Radiation Protection**	**New Substances Assessment and Control**
Protecting public from hazardous products and substances	○	○	○	○	○
Enforcing and ensuring compliance with acts and regulations	○	○	n/a	○	n/a
Conducting regular surveys, research, and surveillance	○	○	○	○	–
Responding to emergencies or product complaints	–	○	n/a	○	n/a
Issuing timely and accurate health warnings to the general public	○	–	n/a	○	n/a
Conducting appropriate risk assessments (for example, new products)	–	○	n/a	○	○

○ Insufficient level of activity

– Not raised as a concern by Health Canada

n/a Not applicable

Sources: Health Canada's internal study, resource allocation documents, and interviews

Exhibit 8.5 **Examples of post-market compliance and enforcement activities considered by Drug Products and Medical Devices program managers to be insufficient**

Compliance and enforcement activities	Drug Products	Medical Devices
Conducting inspections of manufacturers of drug ingredients	◯	n/a
Reviewing trends, surveillance, market surveys, and complaints on non-compliant products	◯	◯
Sharing and coordinating information and expertise with other regulatory organizations (for example, Canada Border Services Agency)	◯	◯
Inspecting the manufacturing practices of foreign sites and accompanying foreign inspectors at Canadian sites	◯	–
Conducting investigations of clinical trials	◯	◯
Conducting investigations of Internet pharmacies	◯	n/a
Inspecting manufacturing practices and issuing licences	◯	n/a
Investigating reports, complaints, and recalls of medical devices	n/a	◯

◯ Insufficient level of activity

– Not raised as a concern by Health Canada

n/a Not applicable

Sources: Health Canada's internal study, resource allocation documents, and interviews

8.26 Without a program baseline, it is difficult to properly determine the level of funding needed to adequately carry out regulatory responsibilities. We are therefore concluding that Health Canada cannot demonstrate that it allocates adequate financial resources to regulatory programs in order to fulfill its regulatory responsibilities.

8.27 **Recommendation.** Health Canada should establish program baselines for Product Safety, Drug Products, and Medical Devices programs by defining the required level of activities that the programs must carry out in order to meet their regulatory responsibilities of protecting the health and safety of Canadians. It should also identify the targeted performance for these activities, and the resources needed to do this work.

Health Canada's response. Agreed. A review of the funding allocated to the three regulatory programs is currently underway, as well as activities to establish program baselines. The goal is to complete these by 31 March 2008.

Demands on regulatory programs are increasing while funding remains constant

8.28 We examined the funding allocated to the three regulatory programs audited, by sources of funding. Exhibit 8.6 shows the trends in funding from 2003–04 to 2005–06.

8.29 The demands on the three programs are increasing. According to program managers, the number of consumer and therapeutic products in the marketplace is increasing every year due to globalization of the

Exhibit 8.6 Funding trends for the three programs audited ($ millions)

Product Safety	2003–04	2004–05	2005–06
Core funding	8.1	9.9	7.3
Revenue authorized to be respent (fees for services)	0	0	0
Special initiatives	10.3	10.3	10.4
Reallocations (funds taken from or given to a program)	(0.6)	(1.5)	0.5
Total	**17.8**	**18.7**	**18.2**

Drug Products Program	2003–04	2004–05	2005–06
Core funding	7.1	7.1	4.8
Revenue authorized to be respent (fees for services)	28.6	28.6	28.6
Special initiatives	17.1	18.3	21.3
Reallocations (funds taken from or given to a program)	(1.0)	(3.4)	(3.9)
Total	**51.8**	**50.6**	**50.8**

Medical Devices Program	2003–04	2004–05	2005–06
Core funding	2.0	1.1	1.0
Revenue authorized to be respent (fees for services)	7.6	7.6	7.6
Special initiatives	3.4	4.0	4.7
Reallocations (funds taken from or given to a program)	(4.2)	(1.3)	0.4
Total	**8.8**	**11.4**	**13.7**

Source: Health Canada (unaudited)

Canadian market. New technologies and their application are increasing the level of knowledge that Health Canada must acquire, interpret, and maintain to address public concern, provide the oversight functions, and manage the associated risks.

8.30 Since the program funding level is constant but demand on the programs is increasing, it is more difficult for program managers to fully meet the regulatory responsibilities of protecting the health and safety of Canadians.

Using plans in resource allocation decisions

Plans have limited impact on resource allocation decisions

8.31 According to Health Canada's *Financial Management and Control Framework*, plans and budgets are developed based on objectives and expected results to be achieved. The Health Products and Food Branch's guiding principles for resource allocation states, "The business planning process is the overarching framework on which resource allocation decisions should be based." We expected the plans to be developed based on a program's objectives and expected results. We also expected the plans to include the budget necessary to carry out the program and to ensure that the expected results would be achieved.

8.32 We examined the strategic plans that were prepared at the corporate and branch levels. We also examined operational plans developed at the directorate level where they existed and the documents used to make decisions on resource allocation.

8.33 Of the three programs audited, we found that only Product Safety had operational plans for 2003–04 and 2004–05. We found that these plans included objectives and priorities that were consistent with the strategic direction set out in plans developed at the branch and corporate levels. We also found that plans included the program budget. The plans also noted activities that would not be carried out because of insufficient funding, as well as what might happen if those activities were not carried out.

8.34 The operational plans for Product Safety included performance measures without any measurable targets for expected results. In 2003–04, program managers developed a performance measurement framework to monitor the program's performance with respect to outcomes, levels of compliance with acts and regulations, service standards, client satisfaction, and operational and financial performance. In 2004–05 and 2005–06, program managers developed indicators and an approach to collect the necessary data. Program

managers have indicated that they are currently setting measurable targets.

8.35 In 2003–04, only one of the directorates responsible for the delivery of Drug Products and Medical Devices programs prepared an operational plan. It included objectives, priorities, and the funding allocated to the directorate. However, the plan did not include performance measures with targets for expected results.

8.36 The situation improved in 2004–05. We found that all three directorates prepared plans for that fiscal year. Templates were used to standardize the process. The plans included objectives, key indicators, a few measurable targets, and the budget. However, they did not include priorities.

8.37 We found that, when operational plans were prepared, they were used as input to the resource allocation process but resulted in marginal funding changes. The budget each branch and directorate received was based on historical funding levels rather than on plans. Because resource allocation is not based on program objectives and expected results, regulatory programs may not receive the funding they need to achieve their objectives.

8.38 Recommendation. Health Canada should ensure that the operational plans for its regulatory programs include comprehensive information on program objectives and measurable targets for expected results. Health Canada should use these operational plans to make resource allocation decisions.

Health Canada's response. Agreed. Health Canada will continue to improve the operational planning process. In 2006–07, the Department is strengthening the process through the launching of a combined strategic and operational planning process that includes performance measures, indicators and measurable targets, as well as decisions on resource allocations. The completion date for implementing the new process is fiscal year 2007–08.

Using financial and performance information in resource allocation decisions

8.39 According to Treasury Board Secretariat's *Results for Canadians*, "departments and agencies need to produce information on program costs and results required for sound decision making." We therefore expected Health Canada to have financial and performance information to support decisions regarding resource allocation. We also expected Health Canada to produce relevant information on sources of funding, program costs, and program results.

Sources of funding need to be taken into account in resource allocation

8.40 Knowing the sources of funding is important to program managers to guide the resource allocation process because funding may come with conditions. Core funding needs to be allocated to ongoing activities, such as compliance and enforcement activities. When Treasury Board approves funding for special initiatives, it may include financial and/or non-financial conditions that must be respected, and the funds must be spent for the intended purposes. Revenue from industry is used to pay for the costs of running the program and to provide specified service levels and may not be reallocated to other programs.

8.41 We found that program managers for the Product Safety program do not track sources of funding. In HPFB, information on sources of funding was produced at the directorate level in 2003–04, but not in 2004–05. Furthermore, this information, when produced, was not reported to branch management and was not used to allocate resources to the Medical Devices and Drug Products programs.

8.42 **Core funding.** As presented in Exhibit 8.6, the budget for core funding for the three programs audited has significantly decreased over three years: 10 percent for the Product Safety program, 32 percent for the Drug Products program, and 50 percent for Medical Devices program. The Department needs to ensure that its regulatory programs receive sufficient core funding to fulfill its mandate.

8.43 **Recommendation.** Health Canada should review the core funding allocated to regulatory programs to ensure that all programs receive sufficient funding to meet regulatory responsibilities and to adequately protect the health and safety of Canadians.

Health Canada's response. Agreed. A review of funding allocated to regulatory programs, including core funding, is currently underway and the goal is to complete it by 31 March 2008.

8.44 **Revenue.** According to the *Financial Administration Act* and the *Department of Health Act*, fees charged for a federal service may not exceed the cost of providing the service. We therefore expected Health Canada to know the full program costs for Drug Products and Medical Devices programs, which recover part of their costs through fees. We also expected the Department to have service standards that have been agreed upon by industry. We expected the user fees charged to industry to be based on agreed upon service standards and that revenues would not exceed full program costs.

8.45 We found that Health Canada presents the full program costs for both Drug Products and Medical Devices in the *Departmental Performance Report 2004–2005*. We also found that the costs recovered are less than the full program costs as required by the *Financial Administration Act*. For example, the full program cost for Medical Devices is $21.8 million and Health Canada recovered $7.4 million or 34 percent. Treasury Board policy requires user fees to be tied to performance standards for the services provided. However, we found that service standards have not been fully established for all fees.

8.46 Recommendation. Health Canada should, in consultation with clients, set user fees for Drug Products and Medical Devices program services that are based on clear and measurable service standards.

Health Canada's response. Agreed. Health Canada recently approved a new cost recovery strategy and framework for all its user fees programs, including drugs and medical devices, to align it to the Treasury Board Policy on *Service Standards for External Fees* and to develop a full costing model. The work on the cost recovery strategy and framework is expected to be completed by 31 March 2008.

Building on stakeholder consultations in 2005, Health Canada is renewing its cost-recovery regime for drugs and medical devices in accordance with the Treasury Board policy and the *User Fees Act*. Health Canada has launched consultations with stakeholders in 2006–07 with a goal to complete the work over the next two fiscal years (2007–08 and 2008–09).

8.47 Special initiatives. We found that funds were not always spent for the purposes approved by the Treasury Board. In 2003–04, 12 percent of the $20.5 million that the Drug Products and Medical Devices programs received for special initiatives was transferred to other programs within HPFB. We also found that in 2004–05, 6 percent of the $10.3 million that the Product Safety program received for special initiatives was transferred to other programs within HECSB. Additional funds provided by the Cabinet and the Treasury Board are for specific initiatives. Health Canada must ensure that funds for special initiatives are spent for the purposes intended.

8.48 Reallocations. Funds are reallocated at the corporate and branch levels to address

- emerging priorities, such as government-wide cost-cutting exercises and public health emergencies, such as the emergence of severe acute respiratory syndrome;

- the indirect cost of services to the program such as information technology, human resources, legal services, planning and policy, telecommunications, postage, and accommodations; and
- insufficient funding allocated to regulatory programs.

To fund these costs, branches and programs are asked to contribute part of their budgets.

8.49 At the branch level, funds collected from each program go into a reserve. Program managers redirect money from core funding, revenues (user fees), and special initiatives to pay for the reallocations. From that point on, any conditions attached to the funds can no longer be tracked and monitored. When the funds are reallocated, they may no longer support the program for which the money was intended.

8.50 Reallocations can have a significant impact on program funding. The Drug Products program has seen its contribution to reallocations increase drastically over the three-year period (Exhibit 8.6). Even though Parliament approved additional funds for special initiatives for this program in recent years, we found that the total funding for the program has not increased because the funding taken out of the Drug Products program through reallocations has risen. This means that the program has no additional money to deliver on its regulatory responsibilities, which continue to increase.

8.51 Health Canada needs to monitor the sources of program funding used to pay for reallocations to ensure that the conditions attached to the funding are respected and that it allocates the resources to the intended purposes. The Department also needs to monitor the impact of reallocations on program funding to ensure that the ability to meet the program's objectives is not compromised.

8.52 We conclude that information on sources of funding was not produced and reported on a regular basis for both HECSB and HPFB. Therefore, the branches do not have complete information to allocate resources to the intended purposes.

8.53 Recommendation. Health Canada should ensure that it complies with the conditions of Treasury Board decisions when allocating and reallocating funds internally.

Health Canada's response. Agreed. As part of its Financial Management and Control Framework, the Department is introducing a Budget Management Framework with guidelines on resource allocation and monitoring of Treasury Board decisions.

The Framework will be developed by 1 April 2007, and implementation will begin in fiscal year 2007–08.

Full costs of programs are not considered in decision making

8.54 The Treasury Board Secretariat's *Manager's Guide to Operating Budgets* states, "To make the best decisions managers will need to know the full costs of all aspects of delivering their programs, including the full cost of other delivery options. Full cost means all costs to the government, not just those of the program manager."

8.55 As stated in 8.45, the *Departmental Performance Report 2004–2005* presents the full program costs of the Medical Devices and Drug Products programs. We found that only the direct cost of the Product Safety program is known, not the full program cost.

8.56 We also found that the information on full program costs is not used for resource allocation decisions. It is important to have information on the full costs of delivering a program, including the administration and overhead costs of program activities. Without that, it is difficult for the Department to make realistic requests for special initiatives funding and to ensure the integrity of regulatory programs that are critical to the health and safety of Canadians.

8.57 Recommendation. Health Canada should determine the full cost of delivering its regulatory programs and use this information in its decisions on resource allocation.

Health Canada's response. Agreed. In addition to the review of funding allocated to regulatory programs and the current exercise to establish program baselines, the Department is also implementing its new cost recovery strategy and framework, including the establishment of a full costing model. The implementation of the full costing model is scheduled for fiscal year 2007–08.

Information on results is not used in decision making

8.58 Information on program results shows how well a program is doing and what it has achieved compared with what it intended to achieve (that is, the expected results). According to the federal government's Expenditure Management System, performance information is needed to make informed decisions on the allocation and reallocation of resources and to enhance accountability.

8.59 We found that for the Product Safety program, several performance indicators have been developed, but none have

measurable targets. Without measurable targets, it may be difficult for program managers to know and demonstrate how well the program is doing.

8.60 We found that the three directorates responsible for delivering the Drug Products and Medical Devices programs have made progress in measuring performance. Since 2004–05, all three directorates have performance indicators for most of their activities—a few with measurable targets. Results achieved compared with the few targets that exist are reported at mid-year and at year-end for accountability purposes. However, the information was not used to allocate resources.

8.61 We also found that, for the three programs audited, Health Canada does not measure program efficiency. This would allow the Department to identify where program dollars could be better spent and thus reallocate the funds saved to these activities.

8.62 We conclude that program managers report limited information on results. Furthermore, that information is not used to allocate resources.

8.63 Recommendation. Health Canada should develop meaningful indicators with targets to measure efficiency and results. The Department should use this information in making resource allocation decisions.

Health Canada's response. Agreed. Improvements to the existing performance measurement frameworks are currently underway and will include expected results, indicators, and targets where feasible. Initiatives related to performance measurement will be implemented by 31 March 2008 and performance will be measured on an ongoing basis.

Rationale for resource allocation decisions is not documented

8.64 Health Canada's Financial Management and Control Framework requires that "budget assumptions, risks, estimates, and constraints are documented and monitored" to maintain transparency and accountability.

8.65 At both the corporate and branch levels, we found that the rationale for showing how funding decisions were made had not been documented. There were no detailed minutes of discussions showing the options, priorities, trade-offs for reallocation decisions, and risks that were considered in arriving at funding decisions. Nor were we

provided with any documentation showing the impact of funding decisions on program delivery.

8.66 We found that, when the funding level allocated to a program was lower than what was requested by program managers, there was no documentation explaining which activity would not be carried out and how this decision was reached. For example, the initial budget for one directorate in 2003–04 was $21.5 million. However, the directorate was allocated a budget of only $17.1 million. There was no clear explanation for the reduced amount, the changes required to program delivery, or how the increased risk will be managed in light of this funding decision.

8.67 The Department is taking steps to improve resource allocation (see 8.85 to 8.89).

8.68 **Recommendation.** Health Canada should document the rationale for any allocation and reallocation decisions on its programs, including the long-term consequences of the funding decisions that affect the program's outcome and its ability to adequately achieve its objectives.

Health Canada's response. Agreed. Improvements have been made since 2004–05 in the areas of operational planning, corporate risk profiling, performance measurement, and the resource allocation process. Health Canada will build on the departmental strategic and operational planning process to strengthen documentation on the rationale for resource allocation decisions. Initiatives related to the documentation of rationale for resource allocation and reallocation decisions will be implemented in the 2007–08 operational planning process.

Principles guiding planning and resource allocation are not standardized

8.69 We found that there is no common resource allocation or planning framework in Health Canada. Although the Corporate Services Branch has a *Budget Management Directive* and a *Decision Making Framework*, we found that the two branches we examined (the Healthy Environments and Consumer Safety Branch and the Health Products and Food Branch) also have their own documented resource allocation process, principles, and decision-making framework. We observed that resource allocation was carried out differently from branch to branch, resulting in varied plans based on different allocation assumptions.

8.70 A standardized resource allocation process and practice in Health Canada is necessary for senior management to interpret adequately the cross-branch information given to them and to make informed decisions on the impact of resource allocation on the health and safety of Canadians.

8.71 Health Canada is taking steps to standardize the operational planning process (see 8.85 to 8.89).

8.72 **Recommendation.** Health Canada should standardize its resource allocation process to ensure that the information given to senior management is consistent from branch to branch.

Health Canada's response. Agreed. Health Canada will continue to build on the strategic and operational planning process to ensure the standardization of the resource allocation process. The 2007–08 operational planning process will be standardized.

Reporting program results

There is limited reporting on results achieved with funding received

8.73 According to Treasury Board Secretariat's *Results for Canadians*, "[departments and agencies] must bring together financial and non-financial performance information to link costs with actual or expected results." The Treasury Board Secretariat's *Manager's Guide to Operating Budgets* states that managers are accountable for the results obtained with the resources provided. This is important to ensure good stewardship of resources and effective program delivery. We therefore expected program managers to report to senior management the results achieved in their programs with the funding they received.

8.74 To report results achieved based on funding received, resources have to be linked to results. This means that, at the planning stage, expected results need to be linked to the budget. At year-end, actual results need to be linked to the actual total costs.

8.75 We found that an attempt was made to link resources to results at the planning stage for the Drug Products and Medical Devices programs in 2004–05. However, we found that there was no link between costs and results for any of the programs at year-end. Because of the limited information on results (see 8.58 to 8.62), program managers have incomplete performance information that they can link to financial information. This reduces their ability to report to senior management the results achieved with funding received.

8.76 As mentioned at 8.60, the three directorates responsible for delivering the Drug Products and Medical Devices programs report to

branch management at mid-year the results achieved compared with the few measurable targets that exist. However, there is no reporting of results achieved with funding received to branch management at year-end.

Unfulfilled regulatory responsibilities are not systematically reported to the Departmental Executive Committee

8.77 We expected that shortfalls in funding for the Department's regulatory responsibilities would be reported, along with the reasons for them, to a level where decisions could be made on how to redress the shortfalls. According to the Treasury Board Secretariat's *Manager's Guide to Operating Budgets*,

> ...in the health or safety inspection field, it is often argued that all activities are important and, therefore, must not be constrained by funding limitations. It is the manager's responsibility to review his or her program and allocate resources to the most important activities. Once the manager has exhausted all avenues for reallocation and if serious program deficiencies remain, it is the responsibility of management to bring these to the attention of ministers.

8.78 We also expected program managers to report to Health Canada's senior management on a regular and timely basis on how their programs have met the Department's regulatory responsibilities according to the government's *Regulatory Policy*.

8.79 We found that program managers report regularly to branch management on the funding shortfalls and the activities that they cannot carry out because of insufficient funding (Exhibits 8.4 and 8.5). This information is submitted to the Branch Executive Committee or the Assistant Deputy Minister (ADM), who make the funding decisions.

8.80 The information on funding shortfalls in regulatory programs and the activities that are not carried out because of insufficient funding is not systematically reported to the Departmental Executive Committee. Branches are asked to submit funding requests, based on certain criteria, to the Departmental Executive Committee, for immediate reallocation of internal funds. Branches are asked to try to limit the number of requests to a maximum of three. This exercise is not designed to address ongoing funding shortfalls in regulatory programs but to address emerging issues that require short-term funding.

8.81 Other than the funding requests by branches, and information on actual and forecasted spending compared with the budget, the Departmental Executive Committee does not systematically receive information related to programs' funding shortfalls and their consequences. At the time of the audit, there was no formal process in place to report this information to the Departmental Executive Committee.

8.82 One of the Department's core roles is that of regulator. In our view, the extent to which the Department is fulfilling this role needs to be communicated to the Departmental Executive Committee, which is ultimately accountable for setting the Department's high-level strategic direction. The Departmental Executive Committee is also the only group in Health Canada that can address cross-branch funding issues.

8.83 The Department is taking steps to further involve the Departmental Executive Committee in resource allocation decisions (see 8.85 to 8.89).

8.84 **Recommendation.** Health Canada should develop a reporting mechanism that would require program managers to inform the Departmental Executive Committee systematically about the

- level of financial resources allocated to each program,
- results achieved with the funds, and
- extent to which each program has met its regulatory responsibilities, including significant gaps and their consequences.

Health Canada's response. Agreed. Directorates are now reporting program results and their regulatory responsibilities to their Branch Executive Committee. With the strategic and operational planning process, results will be reported to the Departmental Executive Sub-committee on Finance, Evaluation and Accountability and to the Senior Management Board for final decision. The new operational planning process will be implemented in fiscal year 2007–08. Program results are also reported in the Departmental Performance Report.

Improving resource allocation

Steps are being taken to improve resource allocation

8.85 Health Canada has recognized the weaknesses with the current resource allocation process. To address some of these weaknesses, the Department has redesigned the operational planning process, which is being implemented in fiscal year 2006–07.

8.86 According to Health Canada, the new operational planning process is a significant improvement over the existing one. It is intended to address many of the issues raised in this report. For example, the new process aims to standardize the way in which decisions are documented and ensure that there is a link between departmental priorities and corporate, branch, program, and regional priorities. To achieve these objectives, program managers will be asked to describe the program activities under their responsibility, key priorities, performance measures, funding levels, funding pressures, and lowest priorities. This information will be challenged by a newly created subcommittee to the Departmental Executive Committee. Ultimately, the Departmental Executive Committee will approve the operational plans, which include the level of funding for the program activity.

8.87 As part of the new operational planning process, decisions would be documented, the planning process would be integrated with the resource allocation process, every activity would receive a budget, and senior management (Departmental Executive Committee) would be clear on the expected results based on the funding approved.

8.88 The new process does not address weaknesses in producing information on full program costs and listing sources of funding by programs. Also, the Departmental Executive Committee needs to be informed of results achieved based on funding received.

8.89 Health Canada is still implementing the new process. We are pleased to see that the process is intended to address many of the issues we raised and we encourage the Department to continue with its full implementation.

Conclusion

8.90 One of Health Canada's core roles is that of regulator. The Department needs to know if it is fully meeting its regulatory responsibilities. However, Health Canada has not established, for the three programs audited, the required level of activities that it must carry out to protect the health and safety of Canadians, the targeted performance for these activities, and the resources needed to do this work. Without this information, Health Canada cannot demonstrate to what extent it is meeting its regulatory responsibilities and whether adequate financial resources are allocated to regulatory programs.

8.91 While the total funding allocated to two of the three audited programs has remained constant, all three programs audited received

less funding for core activities in 2005–06 than in 2003–04. Meanwhile, the complexity of and the growing demands on programs could significantly affect Health Canada's ability to meet its regulatory responsibilities.

8.92 To have an effective resource allocation process, Health Canada needs to allocate funds based on plans, risks, and priorities; sources of funding and program costs; and program results. The Department reports full program costs for two of the three regulatory programs audited. Program managers report limited information on results but do not report sources of funding. Even when reported, the information is not used for resource allocation decisions. Rather, Health Canada's system of allocating its resources among its various branches and programs is based on the previous year's funding rather than on plans and sound financial and performance information.

8.93 Program managers report funding shortfalls to branch management. They also report what activities that they cannot carry out because of insufficient funding. This information does not routinely reach the Departmental Executive Committee, which is the only group in Health Canada that can address cross-branch funding issues.

8.94 The Department needs to document its rationale for resource allocation decisions, and hold managers accountable for the results achieved with the funding received. This would ensure that limited resources are allocated to where they would do the most good and program objectives would be met.

8.95 The Department is making progress in resolving some of the issues with its current resource allocation process. Health Canada has redesigned the operational planning process, which is scheduled to be in place in 2006–07. We are pleased to see that the new process is intended to address many of the issues raised in this report and we encourage the Department to continue with its full implementation.

About the Audit

Objectives

The audit objectives are to determine whether Health Canada

- allocates financial resources at all levels according to a plan and with consideration for financial/performance information;
- regularly reports relevant information on sources of funding, program costs, and results at all levels of the organization and uses this information to allocate resources; and
- can demonstrate it allocates adequate financial resources to regulatory programs in order to fulfill its regulatory responsibilities.

Scope and approach

This audit focused on fiscal years 2003–04 and 2004–05, but it also took previous years and 2005–06 into account to study trends in resource allocation. We examined how financial resources are allocated to each branch and how the branches report to senior management on program costs and results.

Since most of the regulatory programs at Health Canada are found in two branches—Healthy Environments and Consumer Safety Branch (HECSB) and Health Products and Food Branch (HPFB)—the audit focused on these two units. We examined how resources are allocated to directorates within each branch. Specifically, we examined their plans, budgets, resource allocation, and decision making. We also looked at reporting by the directorates to senior management on program costs and results.

We selected three programs within HECSB and HPFB: Product Safety, Drug Products, and Medical Devices. We examined the programs' sources of funding (including cost recovery), program costs, results, and budget. We interviewed the program managers reporting to the directorate and branch level to determine how the reports are used in resource allocation decisions.

We have not audited the efficiency or the effectiveness of the three selected programs. We are not commenting on whether the activities that are being carried out to protect the health and safety of Canadians are efficient. Our audit focused on the process by which Health Canada decides what resources to allocate to each of its branches and programs and the information on which it bases those decisions.

Evidence was collected mainly from interviews with key personnel and a documentation review of budgets, plans, resource allocation exercises, and any other relevant information used for decision making on resource allocation.

Criteria

We expected Health Canada would

- have plans that are developed based on objectives, priorities, and expected results to be achieved;
- have budgets related to these plans and allocate financial resources according to plans;
- ensure that relevant information is produced at all levels of the Department regarding sources of funding, program costs, and program results;
- have financial and performance information to support decisions regarding resource allocation;
- ensure funding shortfalls and the reasons for shortfalls are reported to a departmental level where decisions can be made about redressing the situation;
- ensure that managers report results achieved at the program level based on funding received;
- ensure that managers of regulatory programs report to senior management on how the Department's regulatory responsibilities have been met; and
- ensure that financial resources are adequate to carry out regulatory responsibilities effectively.

Audit work completed

Audit work for this chapter was substantially completed on 1 September 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 8. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Department's response
Meeting regulatory responsibilities	
8.27 Health Canada should establish program baselines for Product Safety, Drug Products, and Medical Devices programs by defining the required level of activities that the programs must carry out in order to meet their regulatory responsibilities of protecting the health and safety of Canadians. It should also identify the targeted performance for these activities, and the resources needed to do this work. **(8.14–8.26)**	Agreed. A review of the funding allocated to the three regulatory programs is currently underway, as well as activities to establish program baselines. The goal is to complete these by 31 March 2008.
Using plans in resource allocation decisions	
8.38 Health Canada should ensure that the operational plans for its regulatory programs include comprehensive information on program objectives and measurable targets for expected results. Health Canada should use these operational plans to make resource allocation decisions. **(8.31–8.37)**	Agreed. Health Canada will continue to improve the operational planning process. In 2006–07, the Department is strengthening the process through the launching of a combined strategic and operational planning process that includes performance measures, indicators and measurable targets, as well as decisions on resource allocations. The completion date for implementing the new process is fiscal year 2007–08.

Recommendation	Department's response
Using financial and performance information in resource allocation decisions	
8.43 Health Canada should review the core funding allocated to regulatory programs to ensure that all programs receive sufficient funding to meet regulatory responsibilities and to adequately protect the health and safety of Canadians. (8.40–8.42)	Agreed. A review of funding allocated to regulatory programs, including core funding, is currently underway and the goal is to complete it by 31 March 2008.
8.46 Health Canada should, in consultation with clients, set user fees for Drug Products and Medical Devices program services that are based on clear and measurable service standards. (8.44–8.45)	Agreed. Health Canada recently approved a new cost recovery strategy and framework for all its user fees programs, including drugs and medical devices, to align it to the Treasury Board Policy on *Service Standards for External Fees* and to develop a full costing model. The work on the cost recovery strategy and framework is expected to be completed by 31 March 2008. Building on stakeholder consultations in 2005, Health Canada is renewing its cost-recovery regime for drugs and medical devices in accordance with the Treasury Board policy and the *User Fees Act*. Health Canada has launched consultations with stakeholders in 2006–07 with a goal to complete the work over the next two fiscal years (2007–08 and 2008–09).
8.53 Health Canada should ensure that it complies with the conditions of Treasury Board decisions when allocating and reallocating funds internally. (8.47–8.52)	Agreed. As part of its Financial Management and Control Framework, the Department is introducing a Budget Management Framework with guidelines on resource allocation and monitoring of Treasury Board decisions. The Framework will be developed by 1 April 2007, and implementation will begin in fiscal year 2007–08.
8.57 Health Canada should determine the full cost of delivering its regulatory programs and use this information in its decisions on resource allocation. (8.54–8.56)	Agreed. In addition to the review of funding allocated to regulatory programs and the current exercise to establish program baselines, the Department is also implementing its new cost recovery strategy and framework, including the establishment of a full costing model. The implementation of the full costing model is scheduled for fiscal year 2007–08.

Recommendation	Department's response
8.63 Health Canada should develop meaningful indicators with targets to measure efficiency and results. The Department should use this information in making resource allocation decisions. (8.58–8.62)	Agreed. Improvements to the existing performance measurement frameworks are currently underway and will include expected results, indicators, and targets where feasible. Initiatives related to performance measurement will be implemented by 31 March 2008 and performance will be measured on an ongoing basis.
8.68 Health Canada should document the rationale for any allocation and reallocation decisions on its programs, including the long-term consequences of the funding decisions that affect the program's outcome and its ability to adequately achieve its objectives. (8.64–8.67)	Agreed. Improvements have been made since 2004–05 in the areas of operational planning, corporate risk profiling, performance measurement, and the resource allocation process. Health Canada will build on the departmental strategic and operational planning process to strengthen documentation on the rationale for resource allocation decisions. Initiatives related to the documentation of rationale for resource allocation and reallocation decisions will be implemented in the 2007–08 operational planning process.
8.72 Health Canada should standardize its resource allocation process to ensure that the information given to senior management is consistent from branch to branch. (8.69–8.71)	Agreed. Health Canada will continue to build on the strategic and operational planning process to ensure the standardization of the resource allocation process. The 2007–08 operational planning process will be standardized.
Reporting program results	
8.84 Health Canada should develop a reporting mechanism that would require program managers to inform the Departmental Executive Committee systematically about the • level of financial resources allocated to each program, • results achieved with the funds, and • extent to which each program has met its regulatory responsibilities, including significant gaps and their consequences. (8.73–8.83)	Agreed. Directorates are now reporting program results and their regulatory responsibilities to their Branch Executive Committee. With the strategic and operational planning process, results will be reported to the Departmental Executive Sub-committee on Finance, Evaluation and Accountability and to the Senior Management Board for final decision. The new operational planning process will be implemented in fiscal year 2007–08. Program results are also reported in the Departmental Performance Report.

Report of the Auditor General of Canada to the House of Commons—November 2006

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Report of the Auditor General of Canada to the House of Commons

NOVEMBER

Chapter 9
Pension and Insurance Administration—
Royal Canadian Mounted Police

Office of the Auditor General of Canada



2006



Report of the

Auditor General of Canada

to the House of Commons

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Chapter 9

Pension and Insurance Administration—
Royal Canadian Mounted Police

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.



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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-9E
ISBN 0-662-44373-X

Chapter

9

Pension and Insurance Administration

Royal Canadian Mounted Police

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Pension and Insurance Administration
Royal Canadian Mounted Police

Main Points

What we examined

In 2003, allegations of fraud and abuse in the management of the Royal Canadian Mounted Police's pension and insurance plans triggered an internal audit, which was followed by a criminal investigation by the Ottawa Police Service (OPS). In June 2005, the OPS announced that its 15-month investigation had found abuses of the pension and insurance plans, nepotism, wasteful spending, and override of controls by management. Significant unnecessary or wasteful expenditures resulted, including money spent for work of little value. The Crown counsel advised that there was "no reasonable prospect of conviction on criminal charges". However, two senior officials of the Royal Canadian Mounted Police (RCMP) resigned, and the RCMP considered disciplinary action against others.

We examined whether the RCMP has responded adequately to the findings of the internal audit and the criminal investigation. We examined certain amounts spent on pension and insurance administration. We also examined additional allegations that were brought to our attention during the course of our audit. Finally, we looked at whether the OPS investigation was independent of, and conducted without undue direction or bias by, the RCMP.

While this chapter refers to certain organizations outside the Government of Canada, it must be noted that our conclusions about management practices and actions refer only to those of public servants. We did not audit the records of the external organizations. Consequently, our conclusions cannot and do not pertain to any practices that they followed.

The RCMP pension plan is separate from the Public Service pension plan. It is governed by the *RCMP Superannuation Act* and provides pension benefits to all employees classified as regular or civilian members of the RCMP. The RCMP is responsible for both the management of the plan and the preparation of its financial statements. The Pension Fund, created in April 2000, along with the RCMP Superannuation Account, had a total balance of $12.3 billion

at the time of our audit. It costs the RCMP from $6 million to $14 million a year for pension administration.

The RCMP also provides group life and disability insurance benefits to its regular and civilian members, based to a large extent on members' contributions. The various insurance plans have roughly $30 million on deposit and cost a little over $2 million a year for the RCMP to administer.

Why it's important

RCMP members serve and provide their contributions with the expectation of receiving pension benefits upon retirement in accordance with the *RCMP Superannuation Act*. In addition, insurance contributions represent an investment by members in their future financial security. RCMP plan administrators have an obligation to manage the plans with due diligence, in good faith and in accordance with public service ethics and values. Sound staffing and contracting controls and corporate oversight of senior officials' actions are essential to ensuring that these obligations are met.

What we found

- The RCMP responded adequately to its internal audit and the OPS investigation, but there are still matters that remain unresolved.
- The OPS told us that its investigation was not directed or influenced in any way by the RCMP. The Ottawa Police investigators had direct access to their own senior management and to Crown counsel throughout the investigation. However, the terms of reference for the investigation stated that the lead OPS investigator on the case reported directly to an assistant commissioner of the RCMP. This did not give the investigation an appearance of independence. We found that the RCMP does not have an established policy for ensuring that external investigations of its actions at its request are performed, and are seen to be performed, in an independent and unbiased manner.
- The RCMP reimbursed or credited about $3.4 million to the pension plan for expenses charged to the plans improperly, and it has taken measures to prevent inappropriate charges in the future. It has also taken steps to strengthen controls over staffing, contracting, and review of business cases and information provided to the Treasury Board.
- An estimated $1.3 million was charged to the pension and insurance plans to pay for commissions or products that provided little or no value, and for excessive payments to employees' friends and family members hired as temporary staff. The pension plan has been reimbursed or credited $270,280 of those unnecessary or wasteful expenditures.

- Even though an RCMP disciplinary investigation found that proceeding with disciplinary action was warranted against four of its regular and civilian members, the RCMP decided not to take action as too much time had elapsed.

The RCMP has responded. The Royal Canadian Mounted Police has agreed with each of our recommendations and is in the process of taking corrective action.

Introduction

9.1 The Royal Canadian Mounted Police (RCMP) provides its members with a pension plan and life and disability insurance plans. The plans are administered by its National Compensation Policy Centre (NCPC) in its Human Resources Branch.

Pension activities

9.2 The RCMP pension plan is governed by the *Royal Canadian Mounted Police Superannuation Act* and provides pension benefits to all employees classified as regular or civilian members of the RCMP. It does not apply to public servants working at the RCMP, who are covered by the *Public Service Superannuation Act* and whose pensions are administered by the Treasury Board Secretariat and Public Works and Government Services Canada. The RCMP Pension Plan is a **contributory defined benefit plan** to which RCMP members and the government contribute, and of which the Government of Canada is the **sole sponsor**. This means that benefits are paid to retired members by the Government of Canada as provided by statute. The RCMP is responsible for administering the plan and preparing its financial statements.

Contributory defined benefit plan—A pension plan to which members and/or their employer contribute and benefits are determined by a formula.

Sole sponsor—The entity that assumes financial responsibility for the pension plan.

9.3 As of April 2000, **omnibus legislation (Bill C-78)** amended the RCMP pension scheme to add a pension fund separate from the previous Superannuation Account. Since the amendment, contributions to the new Pension Fund have been transferred to an investment board and invested in the financial markets. Managing the investments is separate from administering the pension plan. As of 31 March 2005, the Public Sector Pension Investment Board held net assets of $1.4 billion for the new Pension Fund. RCMP pension activity for plan participants prior to April 2000 is recorded in the RCMP Superannuation Account, which had a balance of $10.9 billion on 31 March 2005. The RCMP is responsible for the administration of the overall pension plan, which comprises the Pension Fund and the Superannuation Account. From 2001 to 2004, the yearly cost of administering the pension plan ranged from $6 million to $14 million. Administration includes maintaining a database of information for all contributors and retirees. The database is used to

- record the collection of premiums,
- contain information that enables the software to assess eligibility requirements for members,
- provide regular reports to contributors and retirees, and

Omnibus legislation—A parliamentary bill that is made up of a number of related or separate parts. Each part may amend or repeal an existing act, or may enact a new act.

- calculate and initiate pension payments.

9.4 The legislation that created the new Pension Fund also re-established a statutory Pension Advisory Committee with a strengthened mandate to advise and assist the Minister responsible for the RCMP (Minister of Public Safety). The Minister appoints a maximum of eight people to the Committee, which includes representatives of RCMP senior management, regular members, civilian members, a retiree, and a pension expert.

9.5 After the legislation was passed, the RCMP decided that its pension administration needed to be modernized. The RCMP determined that

- the many inaccuracies in the database of members' pension files needed to be corrected,
- the database itself needed to be improved and moved from paper to electronic media, and
- it needed to decide whether it should contract out the administration of the plan.

9.6 The NCPC began a series of projects to address these requirements and modernize its administration of the pension plan. The NCPC also entered into discussions with the Treasury Board Secretariat to determine what administrative costs should be borne by the pension plan and what costs should be paid for by the RCMP from its administrative budget.

Insurance activities

9.7 For at least 50 years, the RCMP has sponsored and administered its members' health and disability insurance benefits, which are based largely on members' contributions. Administering the health and disability plans includes

- enrolling participants in the plans,
- recording the collection of premiums,
- changing the participants' beneficiaries and coverage,
- providing claim forms, and
- ensuring that participants' premiums are sufficient to pay expected future claims.

9.8 The various insurance plans have a balance of about $30 million and cost a little over $2 million a year for the RCMP to administer. A private sector insurance underwriter invests the premiums, pays the claims, and is paid a flat rate per claim and a percentage of the overall premiums.

9.9 The RCMP Insurance Committee reviews the design and administration of the insurance plans to ensure that participating members of the RCMP receive the maximum level of benefits to which they are entitled. The Committee is chaired by the RCMP's Deputy Commissioner for Federal Services and the Central Region and is made up of six members, including RCMP managers, current and retired members, and regular and civilian members.

9.10 In parallel with modernizing the administration of the pension plan, the RCMP also began to consider outsourcing the administration of the insurance plans. As pension and insurance matters involved many of the same RCMP managers, these projects developed links between them (see paragraphs 9.32 and 9.50).

RCMP managers misused pension and insurance money

9.11 Working under the RCMP's Chief Human Resource Officer, the Director of the NCPC managed the projects to modernize the administration of the pension plan and outsource the administration of the insurance plans. On 28 May 2003, the Commissioner of the RCMP first became aware of potential irregularities in the administration of the pension plan. The RCMP initiated a criminal investigation on 23 June 2003. The Commissioner then cancelled it two days later to conduct an internal audit to more clearly identify issues and help determine if an external investigation was warranted. The internal audit was concluded in October 2003.

9.12 At the RCMP's request, the Ottawa Police Service (OPS) opened a criminal investigation on 31 March 2004. The OPS concluded this investigation in June 2005. Based on the findings of the 15-month long investigation, **Crown counsel** advised that there was "no reasonable prospect of conviction on criminal charges". However, the investigation did identify several significant problems involving abuse of the pension and insurance plans, nepotism, wasteful spending, and instances of management overriding controls.

Crown counsel—The lawyer representing the Crown (federal or provincial jurisdiction). In complex cases, the Crown counsel may review investigation results and advise on the prospect of conviction, given the evidence collected.

9.13 RCMP internal staff reviews, internal audits, and the OPS investigation all concluded that certain individuals misused resources

and circumvented management controls. The following are the most significant findings:

- The NCPC Director ignored normal staffing processes. Friends and relatives of the NCPC Director and of incumbent employees were hired to work on correcting data in the pension database. Most of the staff were hired as summer students, but without using the recommended Federal Student Work Experience Program and at higher than normal rates of pay.
- The NCPC Director established consulting contracts valued at over $20 million, overriding controls to avoid competitions for the contracts. These contracts resulted in some work of questionable value being performed, and excessive fees for administrative services of little or no value being charged to the pension plan.
- Over $3.1 million was inappropriately charged to the pension plan to pay for RCMP human resource projects that should have been paid for by RCMP appropriations funding. This had the effect of relieving budget pressure on managers responsible for these projects.
- The RCMP persuaded the insurance carrier to subcontract work to a second firm to administer insurance plans on behalf of the RCMP. As a result, there was no competition for a $4.6 million contract.
- There were irregularities in the process for contracting out the administration of the pension plan. The contracting decision was not based on an adequate business case.

The former Director of NCPC told us that, to his knowledge, RCMP staffing and contracting policies and practices were followed.

Focus of the audit

9.14 We examined

- whether the agreement between the RCMP and the OPS was structured to avoid undue RCMP direction or bias,
- whether the RCMP has responded adequately to all significant deficiencies that the OPS found during its investigation, and

- whether the breakdowns in controls resulted in significant costs, poor value for money, or misuse of funds.

9.15 We also examined allegations that were brought to our attention during the audit. All matters for which sufficient evidence exists to support conclusions are included in this chapter.

9.16 We did not examine the performance of the Ottawa Police Service or other organizations outside the Government of Canada.

9.17 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Actions taken by the RCMP

Most required corrective action has been taken

9.18 The Royal Canadian Mounted Police (RCMP) has acted to respond to internal audits and the Ottawa Police Service (OPS) investigation. The Chief Human Resources Officer resigned as a result of the RCMP internal audit. The RCMP suspended the National Compensation Policy Centre (NCPC) Director, who subsequently resigned. In addition, the RCMP has

- reviewed expenditures for the administration of the pension and insurance plans,
- reimbursed or credited the pension plan for expenditures that it determined were inappropriate,
- strengthened controls for contracting,
- changed the Pension Accounting Unit to report to Corporate Management and Comptrollership instead of Human Resources,
- established a Pension Finance Oversight Committee to advise the Chief Human Resources Officer and the Deputy Commissioner of Corporate Management and Comptrollership on the administration of the pension plan and administrative expenses charged to the pension plan,
- started a review of insurance administration, and
- announced that it will conduct an evaluation of pension outsourcing.

9.19 At the end of its investigation, the OPS reported several breakdowns of management controls. We examined the corrective actions taken by the RCMP to address the OPS report.

9.20 Inappropriate use of the pension plan. The RCMP made it a priority to identify expenses that had been incorrectly charged to the pension plan. To address improper charges made in fiscal years 2000–01 to 2003–04, the RCMP reimbursed or credited the pension plan by about $1.9 million in 2003–04, and about $1.5 million in 2004–05. The RCMP's Finance Branch reviewed the NCPC's identification of improper charges made to the pension plan related to the outsourcing of insurance administration work and found the methodology consistent and reasonable. However, the Finance Branch concluded that because the police investigation and internal audit had found significant internal control weaknesses at the NCPC, it was impossible to accurately determine how much to reimburse or credit the pension plan.

9.21 We agree with the Finance Branch's conclusions that the RCMP used a reasonable method to identify, estimate, and reverse inappropriate charges to the pension plan.

9.22 Preventing inappropriate charges to the pension plan in the future. The following improvements made by the RCMP will help prevent inappropriate charges to the pension plan in the future:

- The RCMP established a Pension Finance Oversight Committee to advise the Chief Human Resources Officer and the Deputy Commissioner of Corporate Management and Comptrollership, on the administration of the pension plan and charges made to the pension plan. The Committee's role is to provide a challenge function (review and question pension administration proposals and decisions) and not to actually administer the plan. The Committee is currently in active operation.
- The Pension Finance Oversight Committee established guiding principles for charging costs to the pension plan. According to these principles, the NCPC pension accounting unit now monitors and approves all invoices paid through the NCPC, to ensure that only pension-related items are charged to the pension plan.

9.23 Circumvention of staffing controls. In May 2002, an RCMP staffing officer expressed concerns about nepotism in hiring casual employees for the NCPC. Human Resources staff claimed that because of work pressures, they allowed the NCPC Director to hire casual employees on his own rather than following the regular staffing

process. The OPS interviewed 65 of these casual employees and found that 49 had friends or family who worked for the RCMP.

9.24 In 2003, the Chief Human Resource Officer informed Internal Audit that Human Resources would review all proposed new positions and would coordinate and approve all staffing actions. As part of our audit, we reviewed selected staffing and classification files. We found that the staffing files were complete and adequately supported staffing decisions but that one classification decision was based on questionable information.

9.25 In 2004, the RCMP took action to better control NCPC staffing by requiring that the Centre's staffing plan be incorporated into information provided to the Treasury Board Secretariat and reviewed by the Pension Finance Oversight Committee.

9.26 Government contracting policies were not followed. As part of the OPS investigation, the RCMP commissioned a forensic report of 135 contracts worth over $20 million. The report concluded that the contracting processes used by the NCPC would not pass the test of public scrutiny. It found that, for a majority of these contracts, the NCPC Director did not apply a fair or competitive contracting process. He established contracts without competition and circumvented controls designed to ensure fairness, equity, and the lowest price.

9.27 The RCMP has taken measures to strengthen its contracting controls. The RCMP's Corporate Procurement Directorate now ensures that

- managers are reminded of RCMP contracting policies and that managers who do not comply with policies are sanctioned,
- there is a quality assurance program for contracting, and
- procurement personnel receive mandatory values and ethics training.

It is our opinion that these measures are an adequate response to control problems. However, the problems we found were not due to an absence of controls but were due to management overriding controls.

Areas for improvement

The RCMP lacks a policy for external investigations

9.28 We expected that an investigation of the Royal Canadian Mounted Police (RCMP) by an external police force would avoid undue RCMP direction or bias or the appearance of such. The RCMP and the Ottawa Police Service (OPS) formalized the structure of the investigation in a memorandum of understanding, but it was not signed

until 10 months after the investigation began. In our view, however, this is an improvement over previous investigations of the RCMP by external police forces that we reviewed and that did not have a memorandum of agreement.

9.29 Even though RCMP communications to the public referred to the investigation as an OPS investigation, there was significant RCMP involvement. The OPS relied on the RCMP to provide resources to conduct the investigation. As stated in the memorandum of understanding, the OPS lead investigator reported to an RCMP assistant commissioner, and the lead investigator's staff included several RCMP investigators. A member of the RCMP described it as an RCMP investigation conducted with OPS assistance. Another perspective was that the role of the RCMP was to facilitate access and provide information about the organization and the subject matter. OPS officials told us that their investigation was not directed or influenced by the RCMP, and they routinely sought input on the case from OPS senior officers and their own legal counsel. However, the fact that the lead OPS investigator reported to the Assistant Commissioner of the RCMP responsible for departmental security—a potential issue area for the investigation—compromised the appearance of the OPS operating without direction or bias.

9.30 We found that the RCMP does not have an established policy to ensure that external investigations requested by the RCMP of its activities are, and appear to be, independent and unbiased. As a result, it is difficult for the RCMP to respond to complaints that an investigation is not independent and unbiased.

9.31 Recommendation. The Royal Canadian Mounted Police should develop and institute a policy to ensure that when it requests an external investigation based on allegations against one or more of its members or employees, the investigation is not only independent and unbiased, but appears to be independent and unbiased.

RCMP's response. We agree. The RCMP will develop and institute a policy to ensure that the external investigations of RCMP members or employees that are requested by the RCMP are independent of RCMP influence.

The pension and insurance plans were used to pay for some work of little or no value

9.32 The OPS report identified several breakdowns in control that led to unnecessary or wasteful expenditures. We estimate that the RCMP charged $1,337,820 to the pension and insurance plans for work of

little value, of which $270,280 was reimbursed or credited to the pension plan (Exhibit 9.1).

9.33 Commissions paid to Consulting and Audit Canada (CAC). The NCPC Director circumvented competitions by using Consulting and Audit Canada (CAC) to hire individuals and firms he had already chosen to do work at NCPC. For each of the contracts, CAC charged a fee for a number of services, including locating a qualified vendor. As was its normal practice, it applied a 15 percent administrative fee to cover its administration and overhead costs. Since the vendor had already been selected, the RCMP obtained little or no value from these fees, which we estimate to be $666,700.

9.34 The RCMP paid for the same work twice. The Director of the National Compensation Policy Centre (NCPC) instructed the insurance carrier, Great-West Life, to begin preparing for outsourcing the administration of the RCMP employee insurance plans. This preparatory work was performed by Great-West Life without a contract—contrary to contracting regulations. After working on the project for several months, the RCMP requirements changed and Great-West Life determined that it could not provide all the required services within the specified delivery date. It was persuaded to act as a go-between for payments to another firm, Morneau Sobeco, which took on the job of administering the insurance plans for the RCMP. The RCMP then paid Morneau Sobeco for the firm's own requirements definition phase of the contract, indicating that the contractor started again from the very beginning. RCMP officials could not identify any tangible service performed by Great-West Life. Great-West Life believes that it helped to define requirements for

Exhibit 9.1 **Unnecessary and wasteful expenditures were charged to the pension and insurance plans**

Work paid for	Amount	Portion reimbursed or credited
Fees paid to Consulting and Audit Canada to search for and supervise vendors already employed by the RCMP	$666,700	$0
Payments to Great West Life for duplicate work	$250,000	$0
Portion of $443,000 in **sole-sourced contracts** with consultant to do staffing paid from pension plan	$201,120	$50,280
Excess paid for casual staff who were hired and paid more than the standard rate	$220,000	$220,000
Total unnecessary and wasted expenditures	**$1,337,820**	**$270,280**

Sole-sourced contract—A contract for which the contracting authority does not seek competitive bids.

future outsourcing work. The OPS investigation concluded that the RCMP insurance plans paid over $250,000 in unnecessary payments to Great-West Life.

9.35 Hiring a consultant circumvented staffing regulations. The NCPC Director contracted with a consultant to do the Centre's staffing for about 18 months. The total cost of the contracts awarded to the consultant was over $443,000 during this time. An amount of $201,120 was charged to the pension plan, of which $50,280 was subsequently reimbursed or credited. Since the RCMP maintains its own civilian personnel services, it is not clear what value was obtained by hiring an independent consultant. The RCMP contests this conclusion, and believes that this staffing assistance was necessary to meet the timing and service requirements for this important project, requirements that the RCMP staffing function could not meet. It is our opinion that the need was not well supported by the facts and that this particular action, without compensating controls, allowed the NCPC to circumvent staffing regulations.

9.36 Casual staff were hired inappropriately and paid double the standard rate of pay. The Director of the NCPC had at least 52 casual employees hired to correct and consolidate pension data. Human Resources staff suggested using the Federal Student Work Experience Program. However, the Director did not use the program and hired friends and relatives of employees at about double the going rate for students. Our review identified 32 individuals with little or no experience who were hired at about double the student rate. We estimate that excess payments made as a result of the difference in rates amount to about $220,000.

9.37 The RCMP is assessing the value of outsourcing pension plan administration. The RCMP may not have obtained value-for-money when it outsourced the administration of its pension plan. The RCMP is evaluating this issue and plans to complete its report by 31 March 2007.

9.38 Recommendation. The Royal Canadian Mounted Police (RCMP) should review the amounts charged against the pension and insurance plans for work of little or no value and excessive charges to determine whether additional amounts should be reimbursed or credited to the RCMP pension and insurance plans.

RCMP's response. We agree. The RCMP has already begun an extensive review of all charges against the pension and insurance plans. We have also implemented ongoing monitoring to ensure that value-for-money is achieved and only appropriate charges are incurred.

RCMP internal reviews of pension outsourcing and information provided to the Treasury Board Secretariat were inadequate

9.39 RCMP business case for outsourcing the administration of the pension plan. A central element of the RCMP's strategy to modernize pension administration was to determine whether it could be done more economically by the private sector. The RCMP therefore carried out a study to determine if this was so. We reviewed the business case that was used to justify outsourcing the administration of the pension plan to Morneau Sobeco.

9.40 In 2000, the Treasury Board approved the RCMP's submission to outsource the administration of the pension plan. However, we found that the Treasury Board Secretariat was not presented with a balanced business case for outsourcing the administration of the pension plan. The business case was

- written in a way that supported full outsourcing and provided little analysis of any other options for the administration of the pension plan;
- based on estimates of costs provided by Morneau Sobeco, the eventual winner of the outsourcing contract; and
- disputed by Public Works and Government Services Canada; however, there is no evidence that this was ever acknowledged in the decision-making process.

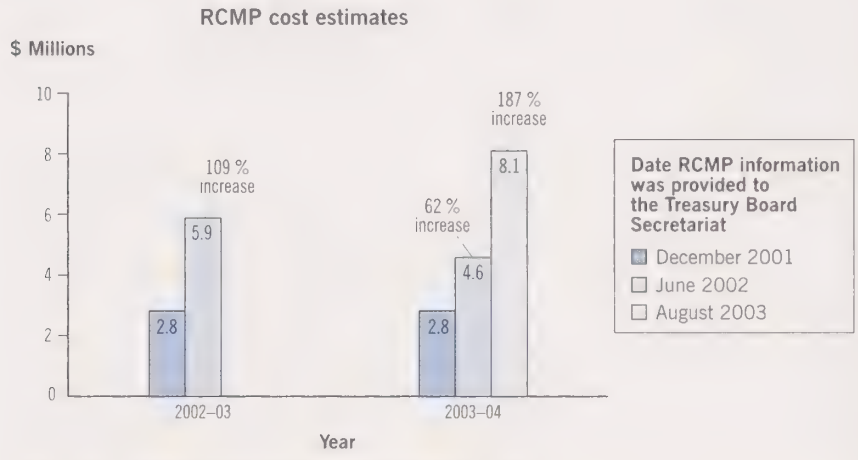
9.41 The RCMP provided Morneau Sobeco with the assumptions used in developing the cost estimates for the administration of the RCMP pension plan, which led to gross underestimation of those costs. These estimates were used as the basis of the contract awarded to Morneau Sobeco for outsourcing. The RCMP accepted these estimates without conducting additional reviews. In the original information provided to the Treasury Board Secretariat, the expected costs for outsourcing the pension plan administration, including those costs for Morneau Sobeco, were estimated to be $2.8 million for each of 2002–03 and 2003–04. Subsequently, in 2002, the RCMP increased its estimate for 2002–03 to $5.9 million. Again in 2003, the RCMP informed the Treasury Board Secretariat of a further increase in its estimate for 2003–04 to $8.1 million, almost three times the original amount (Exhibit 9.2). The RCMP stated that these increases were due to changed assumptions and better estimates once the contract was signed.

9.42 The problems with the information provided to the Treasury Board Secretariat went beyond underestimating the costs of outsourcing the administration of the pension plan. Forecasts for its

ongoing administration and other pension projects were also underestimated as they omitted significant projects, such as cleaning up pension data and operating a pension data repository. For example, revised estimates for 2002–03 were more than four times the original $2.4 million estimate (Exhibit 9.3).

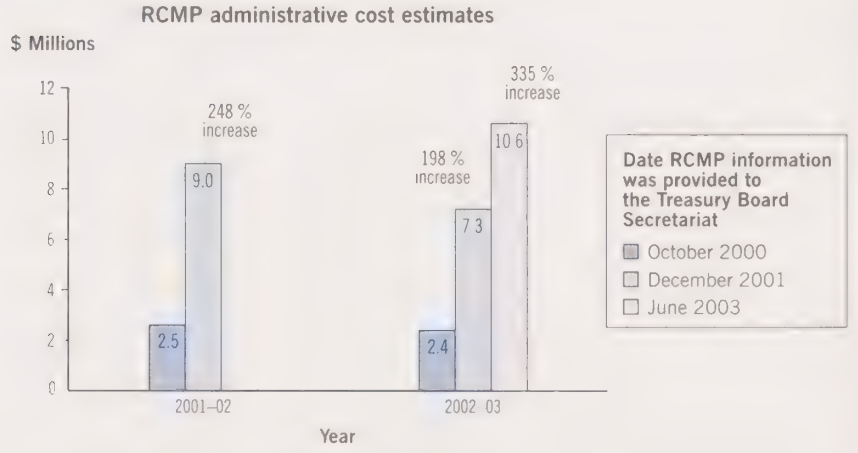
9.43 The RCMP Finance Branch provides advice and helps prepare information to be sent to the Treasury Board Secretariat before being provided to the Treasury Board for consideration. However, we found that the Finance Branch did not challenge the numbers presented by the NCPC in the information provided to the Treasury Board

Exhibit 9.2 The cost of pension outsourcing increased far beyond first estimates given to the Treasury Board Secretariat



Source: From data provided by the Royal Canadian Mounted Police

Exhibit 9.3 Internal pension administration costs continued to escalate



Source: From data provided by the Royal Canadian Mounted Police

Secretariat. In addition, the Branch told us that it relied entirely on the advice and decisions of the NCPC line managers for the decision to outsource the administration of the pension plan.

9.44 Recommendation. As part of its internal review process for each of its submissions to the Treasury Board Secretariat, the Royal Canadian Mounted Police should challenge all important program changes to ensure that business cases are complete and competent.

RCMP's response. We agree. The RCMP already has in place a strong process to challenge all important program changes reflected in Treasury Board submissions and Memoranda to Cabinet; all submissions are supported by comprehensive business cases, which are reviewed by the Pension Finance Oversight Committee; and additional resources are being sought through a business case to the Senior Executive Committee to further strengthen the Finance Branch's challenge role. These measures notwithstanding, the RCMP will continue to work to identify further opportunities to strengthen existing processes.

9.45 Recommendation. The Royal Canadian Mounted Police should open the insurance administration contract to competitive bids at the earliest possible date.

RCMP's response. We agree. The RCMP will open the insurance administration contract to competitive bids at the earliest possible date, but not until the issue of authority related to insurance is resolved.

9.46 External review by the Treasury Board Secretariat. We also examined the Treasury Board Secretariat's review of the information received from the RCMP to determine whether the Secretariat exercised due diligence concerning the outsourcing of the administration of the pension plan. We found that in its analysis of the information originally submitted, Secretariat program analysts had

- identified the importance of the outsourcing decision,
- ensured that the Pension Policy Group at the Treasury Board Secretariat had sufficient time and information to analyze the impact that this decision would have on the other federal pension plans, and
- compared the expected results of the outsourcing project against other plans and questioned the expected benefits.

9.47 The program analysts also challenged the increasing cost estimates in the revised information subsequently provided by the RCMP. However, they did not conduct a detailed review and each time

the analysts questioned the escalating costs, the NCPC staff gave responses that the analysts considered reasonable.

The RCMP's authority to administer its insurance plans is unclear

9.48 Although the RCMP has been administering its insurance plans for more than 50 years, it believes that it may lack the authority to collect premiums and manage insurance plans on behalf of its members. We understand that the RCMP is currently discussing this issue with the Treasury Board Secretariat.

9.49 Recommendation. The Royal Canadian Mounted Police, working with the Treasury Board Secretariat, should ensure that it has the appropriate authority in place to collect premiums and manage its insurance plans.

RCMP's response. We agree. The RCMP will continue to work expeditiously with the Treasury Board Secretariat, as it already has been doing for some time, to ensure that the RCMP has the appropriate authority in place to collect premiums and manage its insurance plans.

The RCMP's insurance plans may have paid too much for outsourcing

9.50 The OPS report noted that the chairs of the Pension Advisory and Insurance committees agreed to partially fund the insurance outsourcing project from the pension plan. The RCMP reimbursed or credited the pension plan, established a Pension Finance Oversight Committee, and created a set of principles to guide what should be charged to the pension plan. However, no such principles or oversight committee was put in place for the insurance plans. As a result, it is unclear whether a portion of the amount paid by the insurance plans for insurance outsourcing should have been paid by the RCMP. The RCMP claims that it lacks the authority to charge administrative costs of insurance plans to its appropriation; however, it was RCMP officials who authorized the original expenditure for the insurance outsourcing project.

9.51 Recommendation. The Royal Canadian Mounted Police should develop charging principles for its insurance plans, and review the amounts charged for outsourcing insurance plan administration according to these principles.

RCMP's response. We agree. The RCMP will be developing charging principles for its insurance plans. Other work is also currently underway to determine the appropriate governance structure, determine the relativity of the plans, and audit the 2004 Financial Statements of the Insurance Plans.

The RCMP did not take disciplinary action against members

9.52 After substantial completion of our audit work, the RCMP informed us that it was no longer considering disciplinary action against RCMP members about whom allegations of misconduct had been received. These were members of the RCMP, not public servants, who were named in the OPS investigation report. The *Royal Canadian Mounted Police Act* requires that a formal disciplinary hearing take place within one year of an appropriate officer knowing of a possible contravention of the RCMP Code of Conduct and of knowing the identity of the member. An internal RCMP policy sets the same deadline for the informal discipline process. The OPS report identified nine regular and civilian members, and following a disciplinary investigation, the RCMP found that disciplinary action was warranted against four of these members. However, the disciplinary investigation also found that too much time had elapsed.

9.53 While information for at least one possible contravention was known as early as 2003, the RCMP only assigned a deputy commissioner to review allegations of misconduct against four of its members in September 2005. It is not clear why this action was not initiated earlier, but we are told by the RCMP that it was following its previous practice of waiting until after the conclusion of the criminal investigation.

9.54 In a separate case, the Federal Court of Appeal ruled, in February 2006, that the one-year deadline referred to in the *Royal Canadian Mounted Police Act* for a formal disciplinary hearing should begin at a much earlier date than the one chosen by RCMP officials. The implications of this court decision were relayed soon after to RCMP officials responsible for discipline. In August 2006, the RCMP decided not to pursue disciplinary action against these members as too much time had elapsed.

Conclusion

9.55 During the Royal Canadian Mounted Police's (RCMP) modernization of its pension and insurance administration, various matters, including several allegations of improper conduct for outsourcing the administration of the pension plan, were brought to the attention of RCMP senior management. An internal audit found non-compliant staffing activities, improper contracting processes, and significant financial waste. A subsequent independent criminal

investigation by the Ottawa Police Service (OPS) resulted in insufficient evidence to provide a reasonable prospect of conviction.

9.56 We found that the agreement between the RCMP and the OPS was not structured in a manner to ensure that the investigation was performed, and was seen to be performed, in an independent and unbiased manner. However, the OPS assured us that its investigation was not directed or influenced in any way by the RCMP.

9.57 We found that the RCMP had reimbursed or credited the amount it estimated had been incorrectly charged to the pension plan. However, it could not determine the exact amount that should be reimbursed or credited to the plan.

9.58 An estimated $1.3 million was spent from the pension and insurance plans to pay for commissions or products for which no value was received and for excessive payments to employees' friends and family members hired as temporary staff. The pension plan has been reimbursed or credited $270,280 for those unnecessary or wasted expenditures.

9.59 The RCMP has responded adequately to control deficiencies identified in internal audits and the OPS investigation. However, it has yet to

- ensure that the external investigations of its operations are designed to be, and appear to be, independent and unbiased;
- review the amounts charged to the pension and insurance plans, for which little value was provided, and determine whether the plans should be reimbursed or credited;
- provide sufficient internal reviews of business cases that support significant initiatives;
- ensure that it has charging principles in place for its insurance plans, and determine whether amounts charged to the insurance plan accounts should have been paid by the RCMP;
- ensure that the insurance administration contract is competitively tendered; and
- clarify the authority of the RCMP to collect premiums and manage its insurance plans.

About the Audit

Objectives

The objectives of this audit were to determine

- whether the Royal Canadian Mounted Police (RCMP) has responded adequately to all significant deficiencies that the Ottawa Police Service (OPS) found during its investigation of the RCMP pension and insurance plans; and
- whether breakdowns in controls resulted in excess costs, poor value-for-money, or misuse of funds.

During our audit, we added the following objective: to determine whether the agreement between the RCMP and the OPS was structured to avoid undue RCMP direction or bias.

Scope and approach

We reviewed RCMP practices by conducting interviews and examining documents. We also looked at the Treasury Board Secretariat's role in reviewing information provided by the RCMP for Treasury Board consideration. We also examined allegations that were brought to our attention during the audit. All matters for which sufficient evidence exists to support conclusions are included in this chapter.

We did not examine the performance of the OPS. When we comment on deficiencies identified in the OPS report, we have independently verified the findings.

While this chapter refers to certain organizations outside of the Government of Canada, it must be noted that our conclusions about management practices and actions refer only to those of public servants. We did not audit the records of the external organizations. Consequently, our conclusions cannot and do not pertain to any practices that they followed.

Criteria

We expected that RCMP practices and decisions would

- comply with the *Financial Administration Act*, the *Public Service Employment Act*, the *Royal Canadian Mounted Police Superannuation Act* and regulations pursuant to the foregoing, including Government Contracting Regulations;
- adhere to Public Service and RCMP statements of ethics;
- implement an action or a plan for action commensurate with the scope and gravity of the deficiency noted in the internal audits and that the OPS report would have been approved by management;
- be designed to give managers good value-for-money from all public expenditures; and
- ensure that the OPS investigation was structured to avoid undue RCMP direction or the perception of bias.

Audit work completed

Audit work for this chapter was substantially completed 9 May 2006, and was updated to reflect further information received up to 12 October 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 9. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Agency's response
Areas for improvement	
9.31 The RCMP should develop and institute a policy to ensure that when the RCMP requests an external investigation based on allegations against one or more of its members or employees, the investigation is not only independent and unbiased, but appears to be independent and unbiased. (9.28–9.30)	**RCMP's response.** We agree. The RCMP will develop and institute a policy to ensure that the external investigations of RCMP members or employees that are requested by the RCMP are independent of RCMP influence.
9.38 The RCMP should review the amounts charged against the pension and insurance plans for work of little or no value and excessive charges to determine whether additional amounts should be reimbursed or credited to the RCMP pension and insurance plans. (9.32–9.37)	**RCMP's response.** We agree. The RCMP has already begun an extensive review of all charges against the pension and insurance plans. We have also implemented ongoing monitoring to ensure that value-for-money is achieved and only appropriate charges are incurred.
9.44 As part of its internal review process for each of its submissions to the Treasury Board Secretariat, the RCMP should challenge all important program changes to ensure that business cases are complete and competent. (9.39–9.43)	**RCMP's response.** We agree. The RCMP already has in place a strong process to challenge all important program changes reflected in Treasury Board submissions and Memoranda to Cabinet; all submissions are supported by comprehensive business cases, which are reviewed by the Pension Finance Oversight Committee; and additional resources are being sought through a business case to the Senior Executive Committee to further strengthen the Finance Branch's challenge role. These measures notwithstanding, the RCMP will continue to work to identify further opportunities to strengthen existing processes.
9.45 The RCMP should open the insurance administration contract to competitive bids at the earliest possible date. (9.39–9.43)	**RCMP's response.** We agree. The RCMP will open the insurance administration contract to competitive bids at the earliest possible date, but not until the issue of authority related to insurance is resolved.

Recommendation	Agency's response
9.49 The RCMP, working with the Treasury Board Secretariat, should ensure that it has the appropriate authority in place to collect premiums and manage its insurance plans. (9.46–9.48)	**RCMP's response.** We agree. The RCMP will continue to work expeditiously with the Treasury Board Secretariat, as it already has been doing for some time, to ensure that the RCMP has the appropriate authority in place to collect premiums and manage its insurance plans.
9.51 The RCMP should develop charging principles for its insurance plans, and review the amounts charged for outsourcing insurance plan administration according to these principles. (9.50)	**RCMP's response.** We agree. The RCMP will be developing charging principles for its insurance plans. Other work is also currently underway to determine the appropriate governance structure, determine the relativity of the plans, and audit the 2004 Financial Statements of the Insurance Plans.

Report of the Auditor General of Canada to the House of Commons—November 2006

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Report of the Auditor General of Canada to the House of Commons

NOVEMBER

Chapter 10
Award and Management of a Health Benefits Contract—Public Works and Government Services Canada and Health Canada

Office of the Auditor General of Canada



2006



Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Chapter 10

Award and Management of a Health Benefits Contract—Public Works and Government Services Canada and Health Canada

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.



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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-10E
ISBN 0-662-44374-8

Chapter

10

Award and Management of a Health Benefits Contract

Public Works and Government Services Canada and Health Canada

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Award and Management of a Health Benefits Contract

Public Works and Government Services Canada and Health Canada

Main Points

What we examined

Health Canada is responsible for providing non-insured health benefits such as drugs and medical supplies to eligible First Nations people and Inuit. In 1997, Public Works and Government Services Canada (PWGSC) awarded a contract to First Canadian Health Management Corporation Inc. to provide claim processing services for Health Canada's Non-Insured Health Benefits (NIHB) program. We looked at whether PWGSC complied with the government's contracting policy when it awarded the contract and whether Health Canada exercised adequate control over public funds spent on the program.

We did not audit claimants' eligibility for the program because we had concluded in an earlier audit (November 2004 Report, Chapter 4, Management of Federal Drug Benefit Programs) that Health Canada had an adequate process to confirm the eligibility of clients and the validity of the drug benefits before approving payments. During that audit, the government's contract with First Canadian Health Management Corporation Inc. came to our attention and we decided to audit the contract the following year.

The reporting of this audit, originally scheduled for April 2006, was deferred because of changes in the parliamentary calendar as a result of the federal election. To update our observations, in August 2006 we obtained information from both organizations on any action they may have taken to address the observations and recommendations in this chapter. We have provided that information at the end of the chapter under **Subsequent Events**.

Our conclusions about contract management practices and actions refer only to public servants and not to any actions by the contractor. The rules and regulations we refer to apply to public servants; they do not apply to contractors. We did not audit the records of the contractor.

Why it's important

From the start of the contract in 1998 until January 2006, Health Canada spent about $104 million on fees to process claims for about $2.6 billion worth of drugs and dental and medical supplies and

equipment delivered to eligible First Nations people and Inuit. Given the importance of the goods and services being provided, as well as the cost of delivering them, it is essential that in contracting for these services, officials at PWGSC and Health Canada protect the interests of the Crown by ensuring that they comply with applicable acts and regulations, including sections 32, 33, and 34 of the *Financial Administration Act*. These sections ensure that the money to pay for the services is available (s 32), that the charge is lawful (s 33), and that the government received what it paid for (s 34).

What we found

- PWGSC could not demonstrate that any of the bidders for the contract had provided evidence of financial stability, even though it was one of the mandatory requirements. Therefore, PWGSC should not have awarded the contract to any of the bidders.
- From 1998 to January 2006, Health Canada did not comply with provisions of the *Financial Administration Act* by making payments of about $2.6 billion to First Canadian Health Management Corporation Inc. (FCH) without the certification required under sections 33 and 34 of the Act.
- Between 1998 and 2003, Health Canada annually tracked payments made to FCH for processing claims. However, it did not track the payments cumulatively over the life of the contract, as section 32 of the *Financial Administration Act* requires. Although the services Health Canada paid for were delivered, payments exceeded the initial value of the contract by $24 million. Since 2003, Health Canada has been tracking payments on a multi-year basis in compliance with section 32 of the Act.
- Our audit work to update our observations found that PWGSC and Health Canada have resolved the contract management issues raised in this chapter. Nonetheless, our mandate requires that we bring to Parliament's attention any matters whose nature and significance warrants it. We are reporting these issues because of their seriousness and the length of time during which some basic financial management controls relating to this contract were lacking.

The departments have responded. PWGSC and Health Canada responded positively to our recommendations and have taken corrective actions. Their responses are included in this chapter.

Introduction

Importance of the contract

10.1 In 1997, PWGSC awarded a contract to First Canadian Health Management Corporation Inc. (FCH) to provide claim processing services for Health Canada's Non-Insured Health Benefits (NIHB) program. PWGSC had to seek the Treasury Board's approval to carry out this procurement, as the value of the contract exceeded PWGSC's approval authority. The contract was valued at $45.7 million for the first five years, with two two-year renewable options. The first option was valued at $14.8 million and the second was valued at $14.4 million, for a total of $74.9 million over nine years. Due to the increasing volume of claims, the total value of the contract was increased in March 2004 to $161.4 million over the nine-year period.

10.2 The NIHB program provides medically necessary health-related goods and services not covered by other provincial, territorial, or third-party insurance plans to about 765,000 eligible First Nations people and Inuit. Goods and services include drugs and dental and medical supplies and equipment.

10.3 Health Canada makes two types of payments to the contractor for the delivery of the NIHB program. The Department pays a processing fee for each claim that service providers submit to FCH. The processing fees have totalled about $104 million since the beginning of the contract to January 2006. The Department also pays the contractor to reimburse service providers for the medically necessary health-related goods and services that they provided to eligible First Nations people and Inuit. Since the beginning of the contract until January 2006, the total costs for the goods and services have been about $2.6 billion.

Past internal audits

10.4 By June 2003, PWGSC was aware that the FCH contract, scheduled to end in November 2003, had exceeded its original value. As a result, at the direct request of the Deputy Minister, PWGSC completed an internal audit of the contract in 2004. The audit focused on procurement and management practices from the time of requisition in 1996 to December 2003. It included a review of key procurement and contract administration documents from PWGSC's records. The audit report has been posted on the Department's website.

10.5 Between 2003 and 2005, Health Canada's internal audit group conducted a series of reviews of the contract. The internal audit group was acting in an advisory capacity at the direct request of the First Nations and Inuit Health Branch. The reviews focused on a number of key contract management areas that were the sole responsibility of Health Canada as the project authority for the contract. However, the reports were not posted on the Department's website.

10.6 In response to the findings identified in PWGSC's internal audit and Health Canada's reviews, both departments developed action plans to resolve problems identified in their reports. We assessed their action plans and concluded that both departments had implemented most of the initiatives outlined in their action plans and that the initiatives addressed the identified problems. Management in both departments are implementing the remaining initiatives.

Focus of the audit

10.7 Our objective was to determine whether

- Public Works and Government Services Canada awarded the contract to First Canadian Health Management Corporation Inc. in accordance with the Treasury Board Contracting Policy, and
- Health Canada complied with relevant authorities and exercised adequate control over public funds spent.

10.8 We examined issues that internal audit groups in both departments had identified, including

- compliance with section 34 of the *Financial Administration Act* (FAA) for the payment of claim processing fees to the contractor,
- implementation of the cost adjustment formula, and
- compliance with the Treasury Board Aboriginal Business Procurement Policy and Incentives.

10.9 We also examined some issues that were beyond the scope of the work carried out by the two departmental internal audit groups, including

- awarding of the contract,
- compliance with sections 33 and 34 of the FAA for the payment of medically necessary health-related goods and services,

- clarity of the Delegation of Financial Signing Authorities document at Health Canada for the payment of medically necessary health-related goods and services, and
- compliance with sections 32 and 34 of the FAA for the payment of claim processing fees.

10.10 More details on the audit objective, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Awarding the contract

None of the bidders met a mandatory requirement, yet PWGSC awarded the contract

10.11 We expected PWGSC to have complied with the Treasury Board Contracting Policy when awarding the contract to First Canadian Health Management Corporation Inc. (FCH). This includes ensuring that bids met all the mandatory requirements, and establishing and structuring procurement files, with a complete audit trail. This facilitates management oversight, particularly in the event of a financial review, subsequent legal action, or an official complaint.

10.12 As the contracting authority, PWGSC is responsible for ensuring that the evaluation of the proposals is conducted according to specified criteria. In this case, there were six mandatory requirements that all bidders had to meet to be considered eligible for selection (Exhibit 10.1).

10.13 One of the mandatory requirements for bidding companies was to provide evidence of their financial stability and current financial position. To meet this requirement, companies were to provide an opening balance sheet, interim financial statements, certification of their sources of working capital, and a listing of all shareholders or owners.

10.14 We believe that the certification of sources of working capital is critical, especially for a newly formed company such as FCH. Working capital demonstrates the amount of assets the company has available to meet its short-term obligations (Exhibit 10.2). PWGSC needed to ensure that the winning bid was financially stable to avoid a potential disruption of service.

10.15 We expected to find supporting evidence on file that demonstrated that the winning bid met the mandatory requirements. PWGSC concluded that four bids met the mandatory requirements. However, the PWGSC file lacked the documents to support this

conclusion. The file did not contain certifications of the organizations' sources of working capital to demonstrate financial stability. We concluded that, without certification of sources of working capital, none of the bids met the mandatory requirement related to financial stability; therefore, PWGSC should not have awarded the contract to any of the four bidders. According to PWGSC's Supply Manual, if all bids fail to meet any of the mandatory requirements, the bidding process must be cancelled.

10.16 PWGSC informed us that since an independent eight-member Technical Evaluation Team had done an evaluation of the four bids and the Department's Legal Services had also reviewed and signed off on this file, the Department believed that it had exercised due diligence in awarding the contract. However, it acknowledged that its files did not contain complete documentation on the decision-making process followed in justifying the award of the contract. Consequently, PWGSC has not been able to provide evidence that one mandatory requirement was met.

Exhibit 10.1 Mandatory requirements for the contract

1. Sign and submit the first page of the Request for Proposal (RFP) document to acknowledge acceptance of and compliance with all provisions set out in the RFP.
2. Sign a certification that demonstrates compliance with the Aboriginal Business Procurement Policy and Incentives.
3. Be a financially stable legal entity that is currently in a sound financial position. Specifically, have
   a. an opening balance sheet on commencement of business,
   b. internal interim financial statements (balance sheet and income statement),
   c. details of sources of working capital to cover any future 90-day period of the company's total operating costs (this must include certification from a professional accountant), and
   d. listings of all shareholders or owners.
4. Have experience, within the last five years, providing automated health information and claim processing systems (or specify corporate relationships that meet this experience requirement).

   Bidders must provide three verifiable references demonstrating that their company meets this experience requirement.
5. Complete and submit the Mandatory Service Requirement Certification form.
6. Complete and submit the Personnel Certification form.

Source: Health Canada—Non-Insured Health Benefits program, Health Information and Claims Processing System, Statement of Requirements, 1997.

Exhibit 10.2 Financial information requirements related to financial stability

Each bidder must provide details of sources of working capital to cover any future 90-day period of the company's total operating costs. This must include certification from a professional accountant (chartered accountant, certified management accountant, or certified general accountant) describing the sources of working capital and a breakdown of expenditures for any such 90-day period. This breakdown should include, as a minimum, salaries, fringe benefits, rent, office supplies, advertising, and other costs.

An explanation of the financing sources for these expenditures must also be provided, covering the above-referenced 90-day period. Information required includes existing cash balances and current working capital and/or value of current line of credit less any draw-downs.

A letter of credit from the company's financial institution may also be included as additional information.

Source: Health Canada—Adapted from Appendix 18 – Financial Information Requirements (Non-Insured Health Benefits program, Health Information and Claims Processing System, Statement of Requirements)

10.17 In our view, the Department's activities to justify awarding the contract are not a replacement for meeting the mandatory requirements, and therefore the contract should not have been awarded to any of the bidders.

10.18 The current contract will expire in November 2007. This means that PWGSC will be posting a competitive Request for Proposal for claim processing services in the near future.

10.19 Recommendation. In awarding the next contract, Public Works and Government Services Canada should comply with the Treasury Board Contracting Policy and ensure that the successful bid meets all the mandatory requirements.

Public Works and Government Services Canada's response. Public Works and Government Services Canada (PWGSC) agrees with this recommendation and will ensure that all contracts awarded comply with the Treasury Board Contracting Policy, including the requirement that successful bidders meet all mandatory requirements.

Since 1997, the rules to determine the extent of maintaining relevant documentation have been strengthened. In 2002, as a result of a Canadian International Trade Tribunal recommendation, PWGSC amended its procedures to ensure that complete documentation is maintained for each procurement.

Managing the contract

Health Canada and PWGSC did not implement two terms and conditions of the contract

10.20 We expected Health Canada and PWGSC to ensure that all terms and conditions of the contract were met throughout the life of the contract and that the interests of the parties were protected.

10.21 Health Canada did not apply the cost adjustment formula. The contract contained a provision to adjust the processing costs per claim if the volume of transactions reached a certain threshold above or below what was originally set out in the contract. If the number of claims per year exceeded the original threshold, a formula would be applied to reduce the processing costs for each claim. If the number of claims per year fell below the original threshold, the formula would be applied to increase the processing costs for each claim.

10.22 For the first five years of the contract, the volume of transactions reached a threshold above what was originally set out in the contract. However, the formula to reduce the processing costs for each claim was not applied. As a result, Health Canada paid the contractor $4 million in unnecessary fees between 1999 and 2004. In an amendment to the contract in August 2004, the contractor and the Crown agreed, as part of contract negotiations, not to apply the formula either retroactively or for the duration of the contract period.

10.23 PWGSC does not know whether the FCH contract complies with the Aboriginal Business Procurement Policy and Incentives. Complying with the Treasury Board's Aboriginal Business Procurement Policy and Incentives is a mandatory requirement of the FCH contract. The policy requires that, where certain contracting requirements and conditions can be assured, contracts over $5,000 and for which Aboriginal populations are the primary recipients be restricted to qualified Aboriginal business suppliers. A business is deemed eligible under the requirements of the policy if it meets the following conditions:

- Any company bidding on a contract must be at least 51 percent Aboriginal owned and controlled.
- The business, if it employs more than five full-time employees, must be staffed with at least 33 percent of Aboriginal workers.
- At least 33 percent of the work done under the contract must be performed by an Aboriginal business.

10.24 Before PWGSC awarded the contract, Indian and Northern Affairs Canada carried out audits to determine whether three companies' bids had met the requirements of the Aboriginal Business Procurement Policy and Incentives. The audits concluded that the three bidders had met the requirement for the Aboriginal ownership component. However, at the time of the audits, the companies had not hired any employees. Because of this, the audits recommended that a post-award audit of the successful bidder be performed once the firm had had a reasonable period of time to establish operations and determine whether the remaining requirements of the Aboriginal Business Procurement Policy and Incentives had been met.

10.25 PWGSC awarded the contract in 1997. In February 2005, as a result of the PWGSC internal audit report, the Department asked Indian and Northern Affairs Canada to conduct an audit, to determine whether FCH was complying with the requirements of the Aboriginal Business Procurement Policy and Incentives. The audit has not yet been completed and, in January 2006, the Crown had not received assurance that the contractor is complying with the requirements of the policy.

Health Canada did not comply with some requirements of the *Financial Administration Act* for goods and services payments

Consolidated Revenue Fund—The general pool of income of the federal government. All money received by the federal government must be credited to this fund and properly accounted for.

10.26 Public servants are expected to take appropriate steps to ensure that they discharge their responsibilities with prudence. The *Financial Administration Act* sets out precise conditions that govern payments out of the **Consolidated Revenue Fund** (Exhibit 10.3).

10.27 We expected Health Canada to take the appropriate steps to ensure that it complied with relevant authorities when making payments to the contractor for medically necessary health-related goods and services covered under the Non-Insured Health Benefits program.

Exhibit 10.3 Requirements of the *Financial Administration Act* for payments

Sufficient funds are available. Departments must ensure that their total spending does not exceed the amount approved (appropriated) for their program by Parliament (section 32).

The charge is lawful. An authorized departmental official must confirm that the expense is a lawful charge against the appropriation (including assurance that value has been received) before requisitioning or releasing payment (section 33).

Value has been received. Before a payment is made for goods or services received, the responsible departmental official must certify that the performance of the work, the supply of the goods, or the rendering of services were in accordance with the terms and conditions of the contract and that the price charged is in accordance with the contract, or in the absence of a contract, is reasonable (section 34).

10.28 Beginning in 1998, Health Canada has sent letters to the Receiver General of Canada giving authorization to make payments to FCH pursuant to section 33 of the *Financial Administration Act*. The funds are paid to FCH and are used to reimburse service providers for the value of the drugs and dental and medical supplies and equipment that have been provided to eligible First Nations people and Inuit under Health Canada's Non-Insured Health Benefits program. Funds of about $15 million are transferred twice a month.

10.29 Although the Receiver General of Canada makes the payments, Health Canada is responsible for ensuring that the requirements of sections 33 and 34 of the *Financial Administration Act* are met because it is the department under which Parliament has appropriated money for the Non-Insured Health Benefits program. We found that since the beginning of the contract, Health Canada has not complied with sections 33 and 34 of the Act.

10.30 Every payment out of the Consolidated Revenue Fund must be accompanied by an authorized signature (certification) under section 34 of the *Financial Administration Act*. We found that in the letters sent to the Receiver General of Canada from 1998 until 2002, Health Canada certified under section 34 once prospectively for the entire year. The Department did not certify each requisition for payment to FCH. We also found that from 2003 to 2006, Health Canada did not certify under section 34 for any of the payments made for the medically necessary health-related goods and services covered under the NIHB program. In both instances, Health Canada either improperly certified under section 34 or did not certify at all. Thus, the Department did not comply with section 34 of the *Financial Administration Act* from 1998 until January 2006.

10.31 Part of the section 34 certification includes verification procedures to ensure that goods and services have been rendered and that the price charged agrees with a contract or is reasonable. We observed that since the beginning of the contract, program officials at Health Canada have carried out some verification work for the payment of medically necessary health-related goods and services under the NIHB program. This verification work includes audits of service providers to ensure that the NIHB program pays for only approved benefits to eligible clients.

10.32 In late 2005, the Department began to develop a payment reconciliation process to ensure that the amounts invoiced by FCH are supported. We did not assess the effectiveness of this process because of its recent development. However, we encourage Health Canada to

continue strengthening its verification procedures for payments to the contractor for medically necessary health-related goods and services. While this verification work is important, it is also essential for the Department to properly certify under section 34 of the FAA.

10.33 Section 33 of the FAA represents the authority of financial officers in a department to requisition payments and charge them against departmental appropriations. The Treasury Board's Policy on Payment Requisitioning and Payment on Due Date states:

> Payment authority must not be exercised before the requisition has been duly certified either in writing or electronically, pursuant to section 34 of the FAA, by a person properly authorized to do so. The payment officer must have adequate assurance that the section 34 certification has been provided.

10.34 Although Health Canada has done some verification work for these payments since the beginning of the contract, the work is not sufficient to authorize and release payments out of the Consolidated Revenue Fund. In the absence of proper certification under section 34 of the FAA, payment authority should not have been exercised pursuant to section 33 of the FAA. This means that from 1998 until January 2006, the Department released payments for medically necessary health-related goods and services without the proper authorization under sections 33 and 34 of the *Financial Administration Act*. Therefore, Health Canada did not have authorization to make payments out of the Consolidated Revenue Fund that amount to about $2.6 billion as of January 2006.

10.35 Health Canada informed us that given the various financial controls in place, including the extensive NIHB provider audit program and the verification work being conducted, it has assurance that payments were made for eligible goods and services covered under the NIHB program. However the Department recognizes that the financial controls currently in place need to be improved to comply with sections 33 and 34 of the FAA.

10.36 Recommendation. Health Canada should comply with sections 33 and 34 of the *Financial Administration Act* for the payment of medically necessary health-related goods and services under the Non-Insured Health Benefits program.

Health Canada's response. Health Canada agrees to take all steps necessary to ensure that all requirements of sections 33 and 34 of the *Financial Administration Act* are met.

Health Canada does not have a clear Delegation of Financial Signing Authorities document for approving goods and services payments

10.37 Health Canada's Delegation of Financial Signing Authorities document, effective October 2004, indicates that the program officer has authority to approve payments up to $5 million. The document also states:

> Exceptions to the financial signing authority limits may be dealt with on an exceptional basis with the recommendation of the Branch Head/Regional Director General and the approval of the Deputy Minister. For example, payments to First Canadian Health can be approved by the delegated Director or Director General even when these payments exceed their delegated financial authority (...)

10.38 Based on how FCH payments were referred to in the Delegation of Financial Signing Authorities document and that bi-monthly payments of about $15 million were well above the $5-million limit delegated to program officials, we expected to find the following:

- a dollar limit for the program officials signing under section 34 of the *Financial Administration Act*, and
- an approval by the Deputy Minister to increase the signing authority of the program officials for these exceptional payments to FCH.

10.39 We did not find either the dollar limit or the approval by the Deputy Minister. Health Canada officials told us that they believed the delegation was correct and that the Deputy Minister's approval of the document itself was the authority necessary for making these exceptional payments to FCH. However, in our view, the wording of the document was not sufficiently clear to avoid differing interpretations.

10.40 Recommendation. Health Canada should modify its Delegation of Financial Signing Authorities document for the First Canadian Health Management Corporation Inc. contract to ensure that the delegated authority to officials signing under section 34 of the *Financial Administration Act* for the payment of medically necessary health-related goods and services is sufficiently clear.

Health Canada's response. Health Canada agrees and will clarify the wording in the Delegation of Financial Signing Authorities document pertaining to the delegated authority of officials approving the payment of medically necessary health-related goods and services.

Health Canada did not comply with some requirements of the *Financial Administration Act* for claim processing payments

10.41 **Section 32 of the *Financial Administration Act*.** Section 32 (2) of the FAA requires departments to establish procedures and maintain records for the control of financial commitments chargeable to each appropriation or item. We found that Health Canada did not track commitments and expenditures on a multi-year basis, which resulted in the Department making payments that exceeded the value of the contract. By 2002, after only four years into the contract, the Department had exceeded the full value of the five-year contract.

10.42 However, it was not until June 2003 that Health Canada and PWGSC officials became aware that expenditures had exceeded the original contract value by $16 million. At the end of the original contract period, 30 November 2003, Health Canada had spent $24 million more than the contract value.

10.43 Health Canada has now taken steps to track expenditures against the value of the contract. Since June 2003, program officers at the Department have been tracking expenditures to ensure that funds are available for the contract before releasing payments. Thus, the Department has been complying with section 32 (2) of the FAA for the FCH contract.

10.44 **Section 34 of the *Financial Administration Act*.** Under section 34 of the FAA, program officers may only approve invoices for payment after ensuring that the goods and services were received and that the price agrees with the contract. We selected a random sample of 154 invoices over seven years to check whether there was adequate documentation to support the volume of claims processed by FCH. We found that all the files contained the certification required under section 34; however, 22 of the 154 invoices had no documentation to support the volume of claims processed. The value of these 22 invoices totalled $5.5 million. For these invoices, it is unclear how Health Canada officials certifying under section 34 obtained assurance that the contractor had invoiced the Department for the correct amounts.

10.45 Health Canada became aware of this situation in December 2003 through an internal review and took steps to strengthen the procedures for complying with section 34. From our sample, we noted that, since 2004, invoices have been accompanied by documentation that supports the payments. Thus, since 2004, Health Canada has complied with section 34 of the FAA for this contract.

Conclusion

10.46 Government policies for contracting and financial management are designed to ensure that government contracting is a transparent and fair process and that prudence and probity are evident in the use of public funds.

10.47 We found that Public Works and Government Services Canada should not have awarded the contract to any of the bidders. Further, PWGSC officials did not always discharge their responsibilities for this contract in accordance with the Treasury Board Contracting Policy.

10.48 PWGSC has taken steps to deal with the issues brought to management's attention as a result of its internal audit report. However, it still needs to address some issues. It needs to obtain assurance that the contractor is complying with the requirements of the Treasury Board Aboriginal Business Procurement Policy and Incentives. In addition, in awarding the next contract, the Department needs to comply with the Treasury Board Contracting Policy.

10.49 Health Canada has also taken corrective action to address the issues identified in its internal reviews. However, some issues still need attention. Health Canada does not properly certify before releasing payments out of the Consolidated Revenue Fund for the payment of medically necessary health-related goods and services, as required by sections 33 and 34 of the *Financial Administration Act*. Health Canada's non-compliance with sections 33 and 34 of the FAA meant that from 1998 until January 2006, the Department paid FCH about $2.6 billion out of the Consolidated Revenue Fund without the proper authorization.

10.50 Furthermore, Health Canada needs to review its Delegation of Financial Signing Authorities document to ensure that the delegated authority to officials signing under section 34 of the FAA for the payment of medically necessary health-related goods and services is sufficiently clear.

10.51 Both departments need to give greater attention to ensuring that departmental officials comply with these relevant authorities.

Subsequent Events

10.52 The tabling of this report was delayed from April 2006 until November 2006 because of changes in the parliamentary calendar as a result of the federal election. We completed the audit fieldwork on 31 January 2006. We conducted additional audit work to update our observations to 1 September 2006. The objective of this additional work was to determine whether Public Works and Government Services Canada (PWGSC) and Health Canada had taken appropriate steps to address issues related to the management of the First Canadian Health Management Corporation Inc. (FCH) contract.

10.53 We examined whether

- PWGSC ensured that the contractor met the Aboriginal Business Procurement Policy and Incentives,
- Health Canada is complying with sections 33 and 34 of the *Financial Administration* Act when making payments for the medically necessary health-related goods and services, and
- Health Canada modified its Delegation of Financial Signing Authorities document to ensure that the delegated authority to officials signing under section 34 of the *Financial Administration Act* for the contract is sufficiently clear.

10.54 In March 2006, Indian and Northern Affairs Canada completed the post-award audit requested by PWGSC to determine whether FCH had complied with the Aboriginal Business Procurement Policy and Incentives. The audit report concluded that FCH met the criteria of the policy and we concur with this conclusion. Therefore, we conclude that seven years after the beginning of the contract, PWGSC has assurance that the contractor is complying with the requirements of the policy.

10.55 We found that since 1 April 2006, Health Canada is complying with sections 33 and 34 of the *Financial Administration Act* for the payment of medically necessary health-related goods and services. Officials are certifying under sections 33 and 34 on each requisition for payment rather than certifying once prospectively at the beginning of each year. We conclude that after seven years into the contract, the Department is now properly authorizing the payments out of the Consolidated Revenue Fund.

10.56 Effective July 2006, Health Canada has a new Delegation of Financial Signing Authorities Document. We found that the Minister clearly delegates signing authority, with a dollar limit, to program

officials certifying under section 34 of the *Financial Administration Act* for the payment of medically necessary health-related goods and services.

10.57 We noted that, on 1 September 2006, Health Canada's internal audit group posted on the Department's website the summary review of the FCH contract that was completed in 2005.

10.58 We conclude that PWGSC and Health Canada have resolved the issues that we brought to their attention in January 2006. We believe that these observations need to be brought to the attention of parliamentarians because of the seriousness of the issues raised and the length of time that some basic financial controls related to this contract were lacking.

About the Audit

Objective

Our objective was to determine whether

- Public Works and Government Services Canada (PWGSC) awarded the contract to First Canadian Health Management Corporation Inc. (FCH) in accordance with the Treasury Board Contracting Policy, and
- Health Canada complied with relevant authorities and exercised adequate control over public funds spent.

Scope and approach

We examined the procurement process that PWGSC used for awarding the contract as well as Health Canada's management of the contract over a seven-year period (1999–2006). As part of our audit work, we examined relevant documentation related to the contract, such as the Request for Proposal, the Statement of Requirements, and the contract amendments. To help determine whether Health Canada managed the contract effectively, we selected a random sample of 154 invoices for claim processing fees charged by the contractor from 1999 until 2005. We examined the invoices to ensure that the payments were in accordance with the terms and conditions of the contract and that Health Canada had in place the appropriate financial controls to ensure compliance with the *Financial Administration Act*.

Criteria

We expected that Public Works and Government Services Canada would ensure compliance with the Treasury Board Contracting Policy and with the Aboriginal Business Procurement Policy and Incentives.

We expected that Health Canada would ensure that

- sufficient funds were committed to cover payments to FCH,
- services rendered and the price charged were according to the FCH contract, and
- the requisitions for payments for the FCH contract complied with relevant authorities.

Audit work completed

We completed the audit fieldwork on 31 January 2006. Since then, we have carried out audit procedures to update our observations up until 1 September 2006. The audit observations and findings as a result of the update are presented in **Subsequent Events** at the end of the chapter.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 10. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Departments' responses
Awarding the contract	
10.19 In awarding the next contract, Public Works and Government Services Canada should comply with the Treasury Board Contracting Policy and ensure that the successful bid meets all the mandatory requirements. (10.11–10.18)	**Public Works and Government Services Canada's response.** Public Works and Government Services Canada (PWGSC) agrees with this recommendation and will ensure that all contracts awarded comply with the Treasury Board Contracting Policy, including the requirement that successful bidders meet all mandatory requirements. Since 1997, the rules to determine the extent of maintaining relevant documentation have been strengthened. In 2002, as a result of a Canadian International Trade Tribunal recommendation, PWGSC amended its procedures to ensure that complete documentation is maintained for each procurement.
Managing the contract	
10.36 Health Canada should comply with sections 33 and 34 of the *Financial Administration Act* for the payment of medically necessary health-related goods and services under the Non-Insured Health Benefits program. (10.26–10.35)	**Health Canada's response.** Health Canada agrees to take all steps necessary to ensure that all requirements of sections 33 and 34 of the *Financial Administration Act* are met.
10.40 Health Canada should modify its Delegation of Financial Signing Authorities document for the First Canadian Health Management Corporation Inc. contract to ensure that the delegated authority to officials signing under section 34 of the *Financial Administration Act* for the payment of medically necessary health-related goods and services is sufficiently clear. (10.37–10.39)	**Health Canada's response.** Health Canada agrees and will clarify the wording in the Delegation of Financial Signing Authorities document pertaining to the delegated authority of officials approving the payment of medically necessary health-related goods and services.

Report of the Auditor General of Canada to the House of Commons—November 2006

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Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Chapter 11

Protection of Public Assets—
Office of the Correctional Investigator

Office of the Auditor General of Canada



2006



Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Chapter 11

Protection of Public Assets—
Office of the Correctional Investigator

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.



The Report is available on our website at www.oag-bvg.gc.ca.

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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-11E
ISBN 0-662-44375-6

Chapter

11

Protection of Public Assets

Office of the Correctional Investigator

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Protection of Public Assets
Office of the Correctional Investigator

Main Points

What we examined

The Office of the Correctional Investigator (OCI) acts as an ombudsman for federal offenders. It investigates complaints of individual offenders and tries to resolve them by making recommendations to Correctional Service Canada.

We examined whether the former Correctional Investigator's and OCI managers' personal leave, absences, cash-out of annual leave (vacation leave), and travel and hospitality expense claims complied with the *Financial Administration Act* and applicable Treasury Board policies, and whether they were managed with prudence and probity. Further, we examined whether the OCI's human resources management practices complied with Public Service Commission policies and applicable Treasury Board policies and practices. Our audit covered the period from 1 April 1998 to 31 March 2004; however, some transactions relating to annual leave were examined back to an earlier date. The audit included current and former OCI employees at the executive level, as well as the former Correctional Investigator who headed the agency during the audited period.

We also examined whether Public Safety and Emergency Preparedness Canada (formerly the Department of the Solicitor General), in providing the OCI with financial and human resources services, complied with the *Financial Administration Act,* applicable Treasury Board policies and practices, and Public Service Commission policies. We examined whether the Treasury Board Secretariat, the Public Service Commission, and the Privy Council Office carried out adequate oversight of the OCI.

Why it's important

To maintain the public's trust and confidence in government, agency heads and senior management are required to discharge their responsibilities in accordance with the highest ethical standards of integrity, objectivity, and impartiality. Their conduct and their actions are expected to exemplify the values of the public service.

Appropriate comptrollership and management are essential in any federal organization to manage financial risks and protect against

fraud, financial negligence, violations of financial rules or principles, and losses of assets or public money.

What we found

- The former Correctional Investigator and head of the OCI, Mr. Ronald Stewart, committed serious abuses and wrongdoing, some of which resulted in substantial personal benefit. For example, he received improper payments in the form of unearned salary and reimbursement of travel and hospitality expenses unrelated to OCI business.
- The former Correctional Investigator did not report a single day of annual leave (vacation leave) for 14 years. He received payments for the full amount of his annual leave entitlements for 14 years. During the 6-year audit period, he was frequently absent from the OCI premises during business days without undertaking OCI business.
- Poor and inappropriate human resources management practices at the OCI had serious financial implications. For example, the former Correctional Investigator authorized improper payments to employees that were recorded as overtime.
- The Executive Director of the OCI was aware of some of the improper activities but took no action to stop them.
- Public Safety and Emergency Preparedness Canada did not challenge questionable expenditures and reimbursements, and problematic human resources classification and staffing practices approved by the former Correctional Investigator.
- The Privy Council Office and the Treasury Board Secretariat issued general guidance material to deputy heads (agency heads) and managers of departments and agencies, but did not carry out appropriate oversight of the OCI that could have enabled them to identify and stop the improper activities.

The organizations have responded. The organizations agreed with all of our recommendations. Detailed responses follow the recommendations throughout this chapter.

Introduction

11.1 The Office of the Auditor General received anonymous complaints alleging questionable practices at the Office of the Correctional Investigator (OCI). The complaints concerned unreported leave, annual leave (vacation leave) cash-out, and human resources staffing practices involving senior managers and the former Correctional Investigator. We decided to audit the OCI to determine whether the alleged practices had occurred.

11.2 The Government of Canada established the OCI in 1973, pursuant to Part II of the *Inquiries Act*. In November 1992, Part III of the *Corrections and Conditional Release Act* established the OCI as a separate agency. The OCI is a small organization with about 27 employees, located in Ottawa. The OCI is a **separate employer** with non-unionized employees.

Separate employer—The Treasury Board is the employer for most of the Public Service of Canada. Within the Public Service of Canada, there are organizations for which the Treasury Board is not the employer. These organizations are called separate employers. Separate employers are subject to minimal ministerial control and direction. Their powers in relation to personnel management and other matters are generally set out in the legislation that creates them.

11.3 The OCI is considered an independent ombudsman agency. The Correctional Investigator, who heads the agency, acts as an ombudsman for federal offenders. The position is independent of Correctional Service Canada. The Correctional Investigator investigates complaints from or on behalf of offenders, at the request of the responsible minister (currently the Minister of Public Safety and Emergency Preparedness Canada) or on his own initiative. The OCI has no power to direct Correctional Service Canada to make changes, but the organization can make recommendations to the Commissioner of Correctional Service Canada or to the Minister. The OCI's primary function is to investigate and help resolve offenders' complaints.

11.4 The Correctional Investigator, whose position is equivalent to a deputy head in the public service, is a full-time Governor in Council appointee. He is appointed for a term not exceeding five years and may be removed for cause by the Governor in Council. An incumbent is eligible for reappointment.

11.5 The issues and practices we raise in this report relate primarily to the former Correctional Investigator, Mr. Ronald Stewart, who held the position for 26 years, from November 1977 to October 2003.

11.6 An agency head (deputy head) has a significant leadership role. As chief executive officer, the agency head is responsible for the agency's work and its effective functioning, including overseeing human resources, finances, public affairs, and programs. The agency head is accountable to the responsible minister and to Parliament.

11.7 The *Corrections and Conditional Release Act* confers on the Correctional Investigator "the control and management of all matters connected with the Office of the Correctional Investigator." An order-in-council delegated to the former Correctional Investigator all of the Treasury Board's powers and functions related to human resources management, on the condition that the Correctional Investigator would exercise such powers and perform such functions in accordance with Treasury Board practices. This means the OCI could have established its own human resources policies, practices, and systems but they would have had to be consistent with Treasury Board standards. However, the OCI did not establish any human resources policies, practices, and systems so is deemed to have made a decision to follow Treasury Board policies, practices, and systems.

11.8 In February 2000, Parliament approved the OCI Supplementary Estimates of $300,000 to address the OCI's backlog of investigations, travel costs, and training, and to develop a case management tracking system. In February 2001, the OCI received $115,000 that had been approved by Parliament for visits to federal penitentiaries and to review investigations. In October 2001, the government approved an increase to the OCI's permanent funding for 2001–02, 2002–03, and 2003–04 in the amounts of $849,000, $955,000, and $905,000 respectively. These additional funds were provided mainly so that the OCI could visit institutions, address issues related to specific offenders, and review investigations of inmate injuries and use of force. These additional permanent funds were conditional on the OCI developing and implementing a strategic corporate plan, which the OCI undertook.

11.9 The Department of Public Safety and Emergency Preparedness Canada (PSEPC), formerly the Department of the Solicitor General, provides the OCI with financial and human resources services. PSEPC's Finance Group records the OCI's financial transactions, and approves and authorizes payments. PSEPC's human resources staff maintain organizational charts, classify positions, process staffing actions, maintain leave balances, and process salary adjustments and annual leave (vacation) cash-out transactions.

Focus of the audit

11.10 Our audit focused on human resources management practices, possible unreported leave, annual leave cash-out, and travel and hospitality expenditures with respect to OCI senior managers and the former Correctional Investigator. We also examined some of the financial and human resources services that PSEPC provided to the

OCI. The audit covered a six-year period from 1 April 1998 to 31 March 2004. Some transactions relating to annual leave were examined back to an earlier date. In addition, we examined some of the financial and human resources services PSEPC provided to two other small independent agencies.

11.11 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Improper and questionable payments

11.12 Our audit has determined that the former Correctional Investigator committed serious abuses and wrongdoing, some of which resulted in substantial personal benefit. We have identified improper payments totalling about $198,000 and questionable payments of about $127,000. These improper and questionable payments totalling $325,000 are detailed in Exhibit 11.1 and explained in this chapter.

The former Correctional Investigator received unearned salary

11.13 Government of Canada executives and full-time Governor in Council appointees are to work no less than an average of 37.5 hours per week on an annual basis. Executives and full-time Governor in Council appointees are not paid overtime.

Exhibit 11.1 Improper and questionable payments to the former Correctional Investigator

Type of improper payments 1998–99 to 2003–04	Approximate amount
Unearned salary	$83,000
Cash-out of annual leave	$95,000
Non-business travel expenses claimed	$7,000
Non-business hospitality expenses claimed	$5,000
Purchase of computer equipment for non-business use	$8,000
Total improper payments	**$198,000**
Type of questionable payments 1990–01 to 1997–98	
Cash-out of annual leave	$127,000
Total payments	**$325,000**

11.14 Our audit determined that the former Correctional Investigator was often absent from the OCI business premises during business days without being engaged in OCI business. He was not part of the OCI Senior Management Committee, rarely attended OCI meetings or functions, and rarely met with anyone on OCI business. We found little evidence that he worked or generated any work product. Senior managers and many employees said they never knew when the former Correctional Investigator would be on OCI premises. Despite having a government cellular phone, he was very difficult to reach when absent.

11.15 Over the six-year audit period, we documented 319 business days when the former Correctional Investigator was absent from the OCI premises, and there was no evidence that he was engaged in any OCI business (Exhibit 11.2).

Exhibit 11.2 Unreported absences of the former Correctional Investigator, 1998–99 to 2003–04

Description of absences with no OCI business	No. of days
Summer residence	258
Travel to cities hosting Grey Cup championship	10
Other domestic travel	9
International travel	12
Annual winter holidays	15
Christmas holidays	15
Total	**319**

11.16 The former Correctional Investigator earned 157 days of annual leave during the six-year audit period, which he did not report having taken. We deducted these days from the 319 days he was absent to arrive at a total of 162 days where he was absent, not working, and therefore receiving unearned salary. The unearned salary for those 162 days amounts to about $83,000 (see paragraph 11.35 for our recommendation).

The former Correctional Investigator generated little work product

11.17 For the purposes of this audit, we define "work product" as anything the former Correctional Investigator did or produced that related to OCI business. This includes such things as reports, memos, letters, notes or additions to files, emails, telephone calls, decisions, or comments that he prepared, worked on, signed or made, and any meetings he attended.

11.18 Except for a few items of correspondence, some travel and hospitality claims, some budget approval forms, and the OCI's annual reports and departmental performance reports, we found that the former Correctional Investigator generated little work product in six years. Senior managers and employees who we interviewed could not recall ever receiving documents or other written information from the former Correctional Investigator about any meetings he may have attended off OCI premises during the audit period.

Annual leave was improperly cashed out

11.19 The documents that Public Safety and Emergency Preparedness Canada's (PSEPC) human resources staff prepared and maintained relating to the former Correctional Investigator's leave balances show that he did not report taking a single day of annual leave during the six-year audit period (1998–99 to 2003–04). We also examined his leave records for previous years and found that he had not reported taking any annual leave from 1990–91 to 1997–98. For 14 years, the former Correctional Investigator did not report taking one day of annual leave.

11.20 Periodically, PSEPC prepared and sent the former Correctional Investigator a leave balance statement that set out any leave taken during the year and balances to be carried over to the new fiscal year. The former Correctional Investigator did not report his absences to PSEPC, as required, to correct his annual leave balance. He accumulated annual leave, even though he was absent from the OCI premises without undertaking OCI business. In fact, when he requested a cash-out of his annual leave, he certified that the balance was correct.

11.21 Executives and Governor in Council appointees are required to cash out unused annual leave that exceeds one year's annual leave entitlement. Every year, the former Correctional Investigator requested that PSEPC cash out his entire previous year's annual leave entitlement. We determined that the former Correctional Investigator improperly cashed out all 157 days of annual leave that he earned from 1998–99 to 2003–04, amounting to about $83,000 in improper payments.

11.22 We also determined that in May 1998, the former Correctional Investigator cashed out 25 days of annual leave, but PSEPC did not adjust his leave balance records to reflect this cash-out. In January 1999, he requested that PSEPC cash out these same annual leave days a second time. Consequently, he improperly received about $12,000, bringing his total to $95,000 for improper cash-out of annual leave (see paragraph 11.35 for our recommendation).

Payments for cash-out of annual leave for earlier years were questionable

11.23 We examined leave records for earlier years. We found that the former Correctional Investigator did not report any annual leave, and cashed out all of his annual leave for 1990–91 to 1997–98. This amounted to about $127,000. Although we did not audit the former Correctional Investigator's absences during this earlier period, OCI employees and managers advised us that the former Correctional Investigator's pattern of absences during this time was similar to the period we audited. We question the appropriateness of these earlier payments totalling $127,000.

11.24 PSEPC processed the former Correctional Investigator's annual leave balance cash-out for 14 consecutive years without questioning or challenging the recurring requests (see paragraph 11.36 for our recommendation).

Non-business travel expenses were claimed and reimbursed

11.25 The former Correctional Investigator claimed travel expenses for 16 trips during the audit period. We could not identify any OCI business conducted during 12 of those trips, and we have concluded that they were personal trips. He submitted travel claims and was reimbursed for ineligible travel expenditures totalling about $7,000 for those 12 trips:

- five to cities hosting the Grey Cup championship,
- four to Kingston,
- one to Toronto,
- one to his high school reunion, and
- one to a Canadian Sports Hall of Fame dinner.

11.26 For five consecutive years during the audit period, the former Correctional Investigator visited the city hosting the annual Canadian Football League championship (Grey Cup) game during the week of the game. On his OCI travel claims, he reported that he was in each city "to investigate inmate complaints." We found no documentation to justify these business trips. The former Correctional Investigator could not provide or remember any details about which inmate complaints he investigated, who he met, or what OCI business he undertook. We could not find any work product associated with these trips.

11.27 The former Correctional Investigator's flights to the cities hosting the Grey Cup championship were always booked months in advance. They were not booked through the government travel agent. Football Canada or the Canadian Football League made the reservations for some of the airline tickets and hotel accommodations. Some invoices were made out jointly to the former Correctional Investigator and Football Canada or the Canadian Football League. Despite that, PSEPC paid the invoices without challenging them. These trips took place during the regular OCI work week, resulting in 10 days of unreported leave.

11.28 We could not find any letters, agendas, institutional reports, or notes related to four trips that the former Correctional Investigator took to Kingston and one he took to Toronto. Furthermore, senior managers were unaware of these trips and the former Correctional Investigator was unable to provide or remember details of the OCI business he conducted when travelling.

11.29 The former Correctional Investigator also attended his high school reunion and a Canadian Sports Hall of Fame dinner, and billed both trips as OCI business. The OCI records do not show any invitation, information, or speech text indicating that the former Correctional Investigator was invited in his official capacity to attend or speak at these functions (see paragraph 11.35 for our recommendation).

Non-business hospitality expenses were claimed and reimbursed

11.30 Treasury Board policy allows public officials to extend hospitality in circumstances when it will facilitate government business or as a matter of courtesy. During the audit period, the former Correctional Investigator submitted hospitality claims for 80 occasions where he claimed he extended hospitality.

11.31 We determined that on 58 of these occasions, the former Correctional Investigator entertained relatives, friends, and acquaintances. These occasions did not facilitate OCI or other government business. In our opinion, these 58 occasions did not warrant extending government hospitality and were personal. Therefore, about $5,000 of ineligible expenses were reimbursed.

11.32 The former Correctional Investigator not only signed his hospitality and travel claims as a claimant, but he also approved all of his own claims. This contravenes Treasury Board policy, which states that no one shall exercise spending authority concerning a payment

from which he or she can personally benefit, directly or indirectly. The former Correctional Investigator had the authority to approve expenditures under sections 33 and 34 of the *Financial Administration Act* (FAA), through the ministerial financial signing authorities (Schedule 1). However, this document specifically denies claimants the ability to approve their own claims. Nevertheless, PSEPC paid all these hospitality and travel claims without challenge, even though the claims did not have the appropriate approval signature (see paragraph 11.35 for our recommendation).

Computer equipment was purchased for non-business use

11.33 The former Correctional Investigator did not know how to use a computer, never used one at work, and did not have a computer in his office at the OCI; however, he authorized the purchase of two computer equipment systems (computer, software, monitor, and printer) for non-OCI business purposes. Members of his family used them. One system cost about $5,000 and exceeded OCI specifications. The former Correctional Investigator gave instructions for this computer equipment to be purchased and picked up in another city, where one of his family members used it. Four months later, the OCI purchased a second computer system costing about $3,000. The former Correctional Investigator took this computer system to his residence in Ottawa, where other members of his family used it.

11.34 We found no evidence that the former Correctional Investigator used either computer system for OCI business. The two computer system purchases constitute improper expenditures and use of government assets, contravening the FAA and applicable Treasury Board policy.

11.35 Recommendation. The Office of the Correctional Investigator, the Treasury Board Secretariat, and the Privy Council Office should submit a report to Parliament setting out the actions that will be taken to identify and recover, where possible, any amount of money improperly paid out, as identified in this report, and the time frame for accomplishing these tasks.

Each organization provided the same response. Agreed. The Office of the Correctional Investigator, the Treasury Board Secretariat, and the Privy Council Office will submit a report to Parliament setting out the actions that will be taken to identify and recover money improperly paid out, and the time frame for accomplishing these tasks.

11.36 Recommendation. The Office of the Correctional Investigator, Public Safety and Emergency Preparedness Canada, and the Treasury Board Secretariat should review the questionable payments for cash-out of annual leave to the former Correctional Investigator for 1990–91 to 1997–98, to determine if the amounts paid out to him were warranted.

Each organization provided the same response. Agreed. The Office of the Correctional Investigator, in conjunction with the Treasury Board Secretariat and Public Safety and Emergency Preparedness Canada, will review the cash-out of annual leave to the former Correctional Investigator for 1990–91 to 1997–98.

The former Correctional Investigator was frequently absent from the Office of the Correctional Investigator

11.37 In our observations of unearned salary and cash-out of annual leave, we documented 319 days when the former Correctional Investigator was absent from the OCI premises during business days, and was not undertaking OCI business (Exhibit 11.2). There was no justification for his absences. We could not find any record of visits to institutions, inmate investigations, meetings attended, or letters, notes, reports, or business telephone calls made during these absences. In addition, OCI senior managers and employees could not identify what OCI business the former Correctional Investigator undertook during these absences, nor could the former Correctional Investigator.

11.38 The former Correctional Investigator spent the majority of his time from April to October each year at his summer residence, located on an island more than one and a half hour's drive from Ottawa. This summer residence had no electricity or land telephone line and was accessible only by boat. We determined that over the six-year audit period, the former Correctional Investigator spent 258 business days in the vicinity of his summer residence without conducting OCI business.

11.39 We identified 19 days when the former Correctional Investigator was away during normal OCI business hours, in Kingston, Toronto, and in the cities hosting the Grey Cup championship. In addition, he took two international business trips where he stayed for an additional 12 days after concluding his OCI business. These were unreported absences.

11.40 During most winters, the former Correctional Investigator was away on vacation for at least one week. He was also absent from the OCI premises during the Christmas holiday period. These unreported absences total 30 days.

11.41 The former Correctional Investigator told us that he regarded his unreported absences as time-in-lieu of hours worked over and above the normal work week, on weekends, or for travel time. He said he had maintained records documenting his excess hours, but had disposed of the records a year after the end of his tenure at the OCI. He could not specify what work necessitated the excessive hours. We found no evidence that the former Correctional Investigator worked any of these excessive hours.

Personal use of a government vehicle

11.42 During the audit period, the former Correctional Investigator had a government vehicle that was dedicated to him, even though our audit determined business use of less than 10 percent annually. We found, however, that the former Correctional Investigator reported to PSEPC that about 85 percent of the vehicle use was OCI related.

11.43 Personal use of an employer-supplied vehicle is a taxable benefit. PSEPC calculated the value of that taxable benefit yearly, based on information the former Correctional Investigator supplied. Our audit determined that from 1998–99 to 2003–04, the PSEPC calculations understated the value of the benefit because of the information the former Correctional Investigator provided. The taxable benefit during the six-year audit period was understated by at least $28,000.

11.44 Recommendation. Public Safety and Emergency Preparedness Canada should review the basis on which it calculated the former Correctional Investigator's taxable benefits for the use of the government vehicle. PSEPC should correct the amounts of taxable benefits it reported for all applicable years.

Public Safety and Emergency Preparedness Canada's response. The Department relied on the information provided by the former Correctional Investigator to calculate the original taxable benefit amount and has no documentation on which to base a recalculation. The matter will be referred to the Canada Revenue Agency for any action deemed appropriate.

Senior managers' practices

11.45 We reviewed senior managers' leave records and determined that some senior managers carried over more than one year's annual leave entitlement. Treasury Board policy and practice requires everyone to cash out annual leave balances exceeding established limits. Three senior managers had large annual leave balances. One senior manager accumulated more than 120 days of annual leave, far more than the 25 days of accumulated annual leave he was eligible to carry over according to Treasury Board policy.

11.46 Public Safety and Emergency Preparedness Canada (PSEPC) informed the Office of the Correctional Investigator (OCI) periodically about the mandatory cash-out policy for each category of employee, and reported the excess annual leave balances of some senior managers. The former Correctional Investigator authorized his senior managers to carry over large annual leave balances; however, there was no justification for these decisions in OCI files.

11.47 We are also concerned about the annual leave reporting and cash-out of annual leave by some senior managers. One senior manager did not report taking any annual leave for three consecutive years. Another senior manager waited until April 2002 to report his annual leave for July and August 2001, and only reported it after he was asked to do so. These two directors cashed out large annual leave balances when they retired in 2002.

11.48 We reviewed the travel claims of senior managers for 2000–01 to 2003–04. We found that they documented and supported the business purposes of their trips, and the claims were reimbursed properly, according to the Treasury Board travel directive.

11.49 We reviewed senior managers' hospitality claims. We found that senior managers made few claims, and that most were for OCI staff meetings. All the claims we reviewed complied with the Treasury Board hospitality policy.

Human resources practices

Human resources were poorly managed

11.50 Although the Office of the Correctional Investigator (OCI), as a separate employer, has the authority to establish its own human resources policies, practices, and systems, it did not do so. Its human resources policies are required to be consistent with Treasury Board standards. We were informed by Treasury Board Secretariat officials that since OCI did not set its own human resources policies, practices, and systems, the separate employer is deemed to have made a decision to follow Treasury Board policies, practices, and systems. During the audit period, the former Correctional Investigator had been delegated by the Public Service Commission all staffing authority except for recruitment from outside the public service and executive staffing.

11.51 The OCI's human resources management practices were poor. Many did not comply with Treasury Board policies and practices or meet the Public Service Commission's staffing values. We wish to emphasize that our concerns are with the actions and processes of the OCI and are not in any way a reflection on the performance, actions,

qualifications, or expertise of the OCI employees who were reclassified or promoted.

11.52 Within a short period, half of the OCI employees were reclassified or promoted. Our review of classification files uncovered differences between what was reported in the departmental performance reports for Parliament, what was submitted to PSEPC for classification action, and what actually happened. For example, organizational charts that the OCI submitted to Public Safety and Emergency Preparedness Canada (PSEPC) in support of reclassifications were incorrect as the number of positions was overstated, responsibilities for some functions were shifted from one position to another, and reporting relationships were sometimes not properly reflected. These elements can affect classification decisions by PSEPC and related staffing decisions by the Public Service Commission.

11.53 The OCI staffing practices were also poor. While the OCI complained about the difficulty of finding qualified investigators, prior to 2002, it did not perform a wide search, and rarely ran competitions that were open to the greater public service or to the general public. When competitions were run, the successful candidate was frequently already working within the OCI on a casual, term, secondment, or on an interchange basis. We noted occasions where language and educational requirements for positions were established to match the profiles of candidates that were already identified.

11.54 An example of questionable human resources practices involved the retroactive reclassification and staffing of three executive-level positions (EX 01) as directors of investigation. The questionable processes were characterized by unusually long periods of retroactivity (33 months in two cases and 18 months in the third). A reclassification of one position to a higher level with no changes to the original position description was made retroactive to the initial date of establishing the position. This resulted in an unusual two-level position increase for the incumbent. There was also a duplication of director positions (three incumbents for two ongoing positions). Unclear organizational charts were presented to the Public Service Commission for staffing purposes. While OCI indicated that it had created a third director position for succession planning and transition purposes, the reason for such an extended overlap period (18 months) was not apparent. Throughout, the OCI was not transparent in its dealings with the Public Service Commission for the staffing of these reclassified positions.

11.55 In addition, all three employees appointed to these executive positions were retroactively granted the maximum performance pay for

fully satisfactory performance. The first two received retroactive performance awards for three years, and the third one for two years. However, there were no performance agreements and appraisals, as required under Treasury Board policies and practices, to justify these performance awards.

11.56 We believe that PSEPC, as the human resources service provider, had a duty to challenge some of the problematic human resources practices at OCI. However, it simply processed whatever it received from the former Correctional Investigator without challenging it.

11.57 Recommendation. Public Safety and Emergency Preparedness Canada should certify and process only human resources and staffing actions that comply with Treasury Board and Public Service Commission policies and practices.

Public Safety and Emergency Preparedness Canada's response. Agreed. The Department will only certify and process staffing actions that are consistent with the Office of the Correctional Investigator's (OCI) Appointment Delegation and Accountability Instrument, and OCI staffing policies. Where there are no OCI policies, Treasury Board and Public Service Commission policies that are relevant will apply.

The former Correctional Investigator authorized improper payments

11.58 Treasury Board policies provide for overtime payments for non-unionized and non-management employees. We were advised that the OCI did not normally compensate employees for working excessive hours. However, for many years, the OCI provided investigators with an additional week off as compensation for excessive hours worked. The OCI did not appropriately manage overtime as managers did not pre-approve overtime or record and track overtime, as required by Treasury Board policy and practices.

11.59 A surplus from the OCI's appropriations was available for 1999–2000, 2000–01, and 2001–02, and therefore the former Correctional Investigator authorized a payment to all full-time, non-management employees. OCI requested these payments as overtime and PSEPC recorded them as such. The OCI determined an amount to be paid out and divided those funds equally among all non-management employees, with the exception of two directors. In 2000, the two directors, who were not considered managers at the time, received double what the other employees received. However, when the two directors were promoted to the executive level, these amounts were deducted from their retroactive salary for the

reclassification to the executive level. The OCI improperly paid out to employees (as overtime payments) $139,000 in 2000, $30,000 in 2001, and $94,000 in 2002, for a total of more than $260,000 over the three-year period.

11.60 The OCI officials had to manipulate calculations to make sure that each employee received about the same amount of money recorded as overtime, despite the differences in their job classifications and salary scales. The former Correctional Investigator signed letters requesting and approving the processing of the payments as overtime.

11.61 The OCI did not maintain employee overtime records. Several OCI employees told us that they did not work overtime or did not work the amount of overtime for which they were paid. Other employees thought the payments were bonuses. These payments contravened the *Financial Administration Act* because they were not associated with actual overtime worked and it cannot be verified that the payments were made to eligible recipients. We could not determine any legitimate reason for the payments.

11.62 As the human resources service provider that processed the overtime payments, PSEPC had a duty to challenge or make inquiries into the peculiarity of almost identical overtime payments to all the non-management employees (see paragraph 11.35 for our recommendation).

11.63 Recommendation. The Office of the Correctional Investigator (OCI), Public Safety and Emergency Preparedness Canada, and the Treasury Board Secretariat should immediately ensure that the OCI has an effective management control framework in the key areas of financial management and human resources management.

Office of the Correctional Investigator's response. Agreed. Since the appointment of the current Correctional Investigator, the Office of the Correctional Investigator undertook, in consultation with the Treasury Board Secretariat (TBS) and Public Safety and Emergency Preparedness Canada, an extensive initiative to modernize the Office's management practices and the implementation of more effective internal control mechanisms. The modernization of the Office included a complete review of its governance structure, financial and human resource management framework, and a re-examination of performance measurement and reporting requirements consistent with government-wide TBS initiatives. The Office has sought third-party independent advice on the adequacy of its current internal control mechanisms.

Public Safety and Emergency Preparedness Canada's response. Agreed. Public Safety and Emergency Preparedness Canada (PSEPC) will provide advice and assist OCI in establishing more effective management practices and control mechanisms. In exercising section 33 authority, PSEPC financial officers will ensure the adequacy of section 34 account verification and ensure that it is being properly and conscientiously followed.

Treasury Board Secretariat's response. Agreed. The Treasury Board and its Secretariat provide general oversight, not day-to-day supervision or control, of departments. Ministers are accountable for respecting Treasury Board financial and administrative policies and, in turn, all deputy heads, including the Correctional Investigator, are expected to follow Treasury Board financial management policies. Bill C-2, The Federal Accountability Act, should it come into force, will reinforce the responsibilities and accountabilities of deputy heads, as "Accounting Officers," in such areas as compliance with government policies, internal control, and signing departmental accounts. In addition, the Federal Accountability Action Plan has mandated a senior committee of deputy ministers to strengthen and streamline Treasury Board financial management policies. This includes an effective financial management control framework. The Treasury Board Secretariat will work with Public Safety and Emergency Preparedness Canada and the Office of the Correctional Investigator to ensure financial management roles and accountabilities are clearly understood.

As a separate agency, however, accountability for human resource management rested solely with the Correctional Investigator. Neither the Treasury Board Secretariat nor the Public Service Human Resources Management Agency of Canada (PSHRMAC) had the authority or accountability to oversee the human resource practices of the OCI. However, PSHRMAC is available to provide advice and guidance to OCI to set up an effective human resources management framework.

Comptrollership and management

The former Correctional Investigator failed to provide effective oversight

11.64 Senior managers and employees told us that the former Correctional Investigator was frequently absent from the office and not very committed to the Office of the Correctional Investigator's (OCI) mandate. They stated that the former Correctional Investigator had little impact on OCI's day-to-day operations.

11.65 Senior managers and employees consulted with the former Correctional Investigator infrequently, since it was difficult to know

when he would be at the OCI office. Files that required action by the former Correctional Investigator often remained unattended for long periods.

11.66 According to the current and former employees we interviewed, morale at the OCI was very poor. Investigators complained about unduly heavy workloads, which were supposed to be relieved by the hiring of new investigators. Employees told us their work environment was difficult and they received little direction, support, or help.

11.67 As a result of the former Correctional Investigator's absences and his inaction, it is our opinion that the former Correctional Investigator did not direct or oversee the organization properly and the OCI functioned for years without appropriate management from its agency head.

The Executive Director's role

11.68 The Executive Director of the Office of the Correctional Investigation (OCI) is the most senior public service executive in the organization. He manages the day-to-day operations of the OCI. As a result of the former Correctional Investigator's absences and inaction, the Executive Director was left to assume most of the agency head's responsibilities.

11.69 All managers in the government are trustees of public resources. Financial management is an integral element of overall management and is not only the concern of financial specialists. Managers have to ensure that transactions comply with the *Financial Administration Act* (FAA), applicable Treasury Board policies, and support government business. When delivering federal programs and services, all managers have a duty to ensure that they do so with prudence and probity.

11.70 The Executive Director was aware of the former Correctional Investigator's absences, some of the annual leave cash-out, and the travel claims being submitted in relation to Grey Cup trips. Further, he was aware of all the overtime payments and was involved in some of the human resources reclassifications and staffing actions. The Executive Director took no action to stop these activities.

11.71 The Executive Director had no role in authorizing the former Correctional Investigator's improper expenditures or approving his conduct. He did not request or approve of the improper overtime payments. He advised us that he indicated to the former Correctional Investigator that the overtime payments were not appropriate.

The Executive Director did not personally benefit from any of these inappropriate transactions.

11.72 The Executive Director had a duty to take timely measures to advise senior government officials of his concerns or suspicions about improper expenditures and inappropriate activities in his organization. He could have advised the Deputy Comptroller General or other officials of the Treasury Board Secretariat, the Deputy Minister or Minister of Public Safety and Emergency Preparedness Canada (PSEPC), or officials of the Privy Council Office.

11.73 Within departments and agencies, the senior financial officer has certain important financial responsibilities, including ensuring that transactions and payments comply with the FAA and are handled with prudence and probity. The Treasury Board Policy on Responsibilities and Organization for Comptrollership states that where the senior financial officer is convinced that an action his or her deputy head is proposing is inappropriate or illegal, he or she must make every effort to persuade the deputy head to follow a different course, including seeking the opinion and advice of the Deputy Comptroller General.

11.74 While the Executive Director signed for many years as the senior financial officer of OCI on the representation letters accompanying the financial statements of the organization for the Public Accounts of Canada, he advised us that he was never the senior financial officer. He thought that function was performed by a PSEPC official.

11.75 It is not clear who was assuming the position and functions of the senior financial officer at the OCI. Documentation in 2004 reflects some confusion or uncertainty among Treasury Board, PSEPC, and OCI as to who was the designated senior financial officer for the OCI. In that year, the Executive Director stopped signing as the senior financial officer. For 2003–04 to 2005–06 there has been no designated senior financial officer for the OCI.

11.76 In our opinion, as the most senior public servant in the organization, the Executive Director had a responsibility to alert government officials in a timely manner about inappropriate financial transactions in his organization and the poor conduct of the former Correctional Investigator. The Executive Director told us that the work habits of the former Correctional Investigator were a source of difficulty for him in the discharge of his own operational role, but he felt unable to effect any change. He further told us that he had informed certain senior officials at the highest levels of PSEPC. In our view, the relating

of this information did not constitute action because it was either not timely or not sufficiently detailed to warrant action by PSEPC.

11.77 Recommendation. The Treasury Board Secretariat should ensure that every small independent organization has a senior financial officer formally designated and appropriately trained on his or her responsibilities and duties.

Treasury Board Secretariat's response. Agreed. As noted in our response to the recommendation at paragraph 11.63, Treasury Board financial management policies are being reviewed by a senior committee of deputy ministers. This review includes the consideration of a new Chief Financial Officer Model for the Government of Canada, including their appointment, competencies, responsibilities, and accountabilities. In the meantime, the current Treasury Board Policy on Responsibilities and Organization for Comptrollership requires deputy heads of all organizations, including the Office of the Correctional Investigator, to designate a senior financial officer having a direct reporting relationship to the deputy head.

11.78 Recommendation. The Treasury Board Secretariat should advise and consult with management of small independent agencies to ensure that they fully understand their responsibilities if they become aware of inappropriate activities by the head of their agencies.

Treasury Board Secretariat's response. Agreed. The Treasury Board Secretariat will work with small departments and agencies to ensure that the roles and accountabilities of senior financial officers under the current policy are clearly understood. This includes the steps that should be taken when the senior financial officer believes the actions of the deputy head place the department at risk or violate the spirit or form of legislation or policy.

Public Safety and Emergency Preparedness Canada did not properly fulfill its responsibilities to the Office of the Correctional Investigator

11.79 The OCI relies on PSEPC to provide financial and human resources services. Among the financial services PSEPC provides the OCI is the certification of financial transactions under section 33 of the FAA, thereby authorizing payments on behalf of the OCI. In discharging this responsibility, PSEPC officials have a duty to ensure that all OCI transactions comply with the FAA and applicable Treasury Board policies. This includes their duty to challenge any questionable expenditure and not to authorize payments that do not comply with the FAA and Treasury Board policies.

11.80 Furthermore, because PSEPC provides human resources services to OCI, in our opinion, PSEPC officials have a duty to ensure that human resources management and staffing practices comply with applicable Treasury Board and Public Service Commission policies and practices. PSEPC needed to obtain the appropriate written justification for any variance in OCI's application of these policies and practices. PSEPC officials also have a duty to challenge any questionable human resources practice.

11.81 According to Treasury Board policy and the signing authority delegation, the former Correctional Investigator was not authorized to approve his own travel and hospitality expenditures. PSEPC is required to ensure that someone with the necessary approval authority, other than the person submitting a claim, certifies that the expenditures are proper and eligible to be reimbursed. PSEPC officials were required to review and challenge the former Correctional Investigator's travel and hospitality claims and annual leave cash-outs, to satisfy themselves that those expenditures were legitimate government expenditures.

11.82 We believe PSEPC had a duty to challenge some of the questionable human resources management and staffing practices at the OCI. PSEPC processed, without question

- the reclassification of OCI employees,
- the requests for employees to carry over excess annual leave, and
- the yearly requests for almost identical overtime payments to all full-time non-management employees.

Further, PSEPC was required to decline authorizing payments for transactions that appeared questionable or non-compliant with the FAA.

11.83 PSEPC officials told us their role was not to challenge OCI expenditures, job reclassifications, or staffing methods or practices. They considered their role simply to supply services to the OCI. Therefore, they did not challenge any of the former Correctional Investigator's actions or decisions, even when they believed they were wrong or inappropriate. PSEPC officials certified and therefore approved all OCI expenditures, staffing, and classification requests because the agency head of the OCI submitted or authorized them. The PSEPC officials stated that the former Correctional Investigator was responsible for his own budget and was accountable for OCI's expenditures and staffing. Therefore, they did not challenge his actions and decisions regarding the finances or human resources of his agency.

11.84 In our opinion, PSEPC officials did not properly fulfill their responsibilities to provide human resources and financial services as they did not challenge but instead approved questionable or inappropriate transactions of the OCI. Therefore, they did not take reasonable and prudent actions as government employees to stop or prevent improper activities at the OCI and failed to report concerns or suspicions to appropriate government officials. PSEPC officials could have reported their concerns to senior officials of the Treasury Board, the Public Service Commission, or the Privy Council Office.

11.85 We expected PSEPC and OCI to have reached a common understanding about the financial and human resources services PSEPC supplies to the OCI, the standards those services have to meet, and the roles and responsibilities of each party. This was not the case.

11.86 Recommendation. Public Safety and Emergency Preparedness Canada should take greater care in fulfilling its role in supplying financial and human resources services. The Department should challenge and, if necessary, refuse to process financial or human resources requests that do not comply with applicable Treasury Board policies and practices and the *Financial Administration Act*.

Public Safety and Emergency Preparedness Canada's response. Agreed. The Department has issued a directive to its human resources (HR) personnel that states that, as HR service providers, their role is to ensure that the advice and services provided to each agency respect the legislative, policy, and regulatory context as well as public service values and ethics, collective agreements, staffing values, and best practices. It has also taken steps to ensure that its financial officers are informed of their respective responsibilities related to the provisions of financial services.

11.87 Recommendation. The Office of the Correctional Investigator should enter into a signed Memorandum of Understanding with Public Safety and Emergency Preparedness Canada (PSEPC). This agreement should specify the financial and human resources services PSEPC will supply, the service standards that should be met, and the roles and responsibilities of each party.

Organizations' response. The Office of the Correctional Investigator (OCI) and Public Safety and Emergency Preparedness Canada will enter into a Memorandum of Understanding (MOU), which outlines each organization's role and responsibilities, as well as the finance, human resources, information management/information technology, and security services to be provided. The OCI has sought third-party

independent advice on this MOU. This will provide further assurance that this new MOU best responds to this important recommendation of the Auditor General.

Public Safety and Emergency Preparedness Canada did not properly fulfill its responsibilities to two other small independent agencies

11.88 During our audit, we learned that PSEPC provides similar financial and human resources services to two other small independent agencies. We therefore examined the way in which it provided these services to them. We determined PSEPC provided the services in the same way as it did for the OCI. PSEPC procedures and practices are supplied in the same manner for all three organizations. We are not implying abuses or wrongdoing in these two other agencies. Our concerns relate to PSEPC and its procedures and practices in providing financial and human resources services to other organizations.

11.89 PSEPC officials process the financial and human resources services for these two other agencies without challenging any of the transactions. PSEPC officials again advised us that heads of these agencies are responsible and accountable for their own funds, and for human resources management and staffing activities in their organizations. PSEPC officials said it is not their role to question those decisions. PSEPC officials certify and therefore approve the expenditures of the two agencies under section 33 of the FAA, without ensuring that the funds have been expended appropriately before payments are issued. Furthermore, PSEPC did not challenge the reclassifications or staffing activities of these two agencies.

11.90 In our opinion, PSEPC is not properly fulfilling its responsibilities to these two agencies for financial and human resources services, since the Department takes no actions to ensure that such services comply with the FAA or applicable Treasury Board and Public Service Commission policies and practices.

11.91 We expected PSEPC and each of these other two small independent agencies to have reached a common understanding about the financial and human resources services PSEPC is expected to supply, the service standards it is to meet, and the roles and responsibilities of each party. This was not the case.

11.92 Recommendation. The Treasury Board Secretariat should reinforce existing guidelines on the responsibilities and accountabilities of service providers.

Treasury Board Secretariat and Privy Council Office provided the same response. Agreed. Legislation and current Treasury Board policies outline certain requirements relating to the provision of services to others and the exercising of duties. The Treasury Board Secretariat (TBS) will review current guidance to determine if revisions are required. In addition, the TBS will work with departments and agencies to provide a better understanding of these responsibilities and accountabilities to reduce the likelihood of similar incidents occurring in the future. The TBS will also remind departments and agencies of the need for Memoranda of Understanding when services are provided to or for others. Finally, the TBS will work with the Privy Council Office to update management and financial accountabilities for the *Guide Book for Heads of Agencies* should Bill C-2, the Federal Accountability Act, come into force.

11.93 Recommendation. Public Safety and Emergency Preparedness Canada (PSEPC) should enter into a Memorandum of Understanding with each of the other two small independent agencies to which it provides financial and human resources services. These agreements should specify the financial and human resources services PSEPC will supply, the service standards that should be met, and the roles and responsibilities of each party.

Public Safety and Emergency Preparedness Canada's response. Agreed. PSEPC and the two agencies will enter into Memoranda of Understanding that will outline each organization's role and responsibilities as well as the finance, human resources, information management/information technology, and security services to be provided.

Central agencies did not adequately oversee independent agencies

11.94 Accountability and oversight. The Privy Council Office's *Guide Book for Heads of Agencies* (1999) requires the minister's office and the Senior Personnel Secretariat at the Privy Council Office to be informed about any situation or issue involving a Governor in Council appointee. The *Guide* explains that a deputy minister is responsible for overseeing the small agencies within a ministerial portfolio.

11.95 However, the *Guide* notes the sensitive nature of the relationship between independent government agencies and the minister responsible for them. An agency must maintain its independence while discharging its mandate, and at the same time act in accordance with government policies and the public interest. Furthermore, because of this need for independence, the expectations for a deputy minister's oversight of

small independent agencies are unclear. The independence issue may discourage both deputy ministers and ministers from intervening, resulting in a lack of oversight of these agencies.

11.96 Privy Council Office officials advised us that there are 38 government organizations that they categorize as independent organizations. We learned that the Privy Council Office does not monitor heads of independent agencies.

11.97 We found considerable gaps in the information available to agencies about accountability and oversight. The Privy Council Office's *Guide* does not adequately explain accountability for management responsibilities (such as finance and human resources). The roles and responsibilities of deputy heads are not clear.

11.98 The Privy Council Office, the Treasury Board Secretariat, and the Public Service Commission all provide considerable written guidance about the behaviour they expect of deputy heads. The former Correctional Investigator told us he received the booklet entitled *Terms and Conditions of Employment for Full-Time Governor in Council Appointees*. However, he said he never received any advice about his responsibilities or the expectations of the Privy Council Office, Treasury Board Secretariat, or the minister or department responsible for the OCI.

11.99 Recommendation. The Privy Council Office, in consultation with the Treasury Board Secretariat, should clearly establish the accountability of the heads of small independent agencies on matters related to financial management and human resources management.

Privy Council Office's response. Agreed. The Privy Council Office will revise its *Guide Book for Heads of Agencies*, which sets out the role of heads of agencies with respect to operations, structures, and responsibilities in the federal government, including a section on the exercise of their responsibility and accountability as defined by statute and by convention. These revisions will provide more details on agency heads' accountability for the management of their organization and clarify their roles and responsibilities as deputy heads.

11.100 Recommendation. The Privy Council Office should ensure that it appropriately advises and trains full-time Governor in Council appointees about their expected standards of conduct as holders of public office.

Privy Council Office's response. Agreed. The Privy Council Office will provide more detailed information when advising appointees, prior

to their appointment, of the conflict of interest rules and other standards of conduct that apply to them. Upon appointment, appointees are contacted by the Office of the Ethics Commissioner to discuss any concerns they may have with respect to their office. The Privy Council Office will provide further written advice to appointees on these matters, following their appointment.

In addition, the section in the *Guide Book for Heads of Agencies* that explains how public service values and probity apply to them will be enhanced to provide more detailed advice. Also, the booklet entitled *Terms and Conditions of Employment for Full-Time Governor in Council Appointees* will be amended by adding a section on standards of conduct.

The Canada School of Public Service provides formal orientation and training sessions for heads of agencies. It is proposed that such training become mandatory for heads of agencies. Individual sessions with Treasury Board Secretariat and Privy Council Office officials, which are currently available upon request, will be provided to agency heads upon their appointment.

11.101 Performance awards. The Privy Council Office did not formally review or appraise the performance of the former appointed heads of the three small independent agencies because of the need to respect their independence. Instead, these appointees automatically received annual lump sum performance awards in recognition of their management responsibilities. We were informed by Privy Council Office officials that since April 2001, full-time Governor in Council appointees identified as requiring independence are classified as GCQ and stopped receiving a performance award as it was incorporated in their salary. However, some incumbents, including the former Correctional Investigator, whose total cash compensation exceeded the maximum of the GCQ salary range, were not converted to the new pay structure. Therefore, the former Correctional Investigator continued to receive his salary and annual performance awards.

11.102 From April 1998 to April 2003, the former Correctional Investigator received a total of about $41,000 in performance awards in addition to his salary, notwithstanding his frequent absences from OCI work premises and lack of work product.

11.103 We appreciate that the Privy Council Office does not wish to compromise the independence of independent agencies. However, before granting a performance award or re-appointing an incumbent, the Privy Council Office needs to conduct some review to ensure that

the head of any small independent agency has performed managerial and administrative functions properly. Our review of Privy Council Office personnel files of former heads of the three small independent agencies we examined contained no information that supported decisions to grant them performance awards or to re-appoint them.

11.104 Audit, monitoring, and evaluation. The Public Service Commission delegates staffing authority to deputy heads through formal agreements. Until 2003, the Public Service Commission relied on self-reporting to ensure accountability. Since then, the Public Service Commission has started to develop a more rigorous, risk-based approach to assessing organizations, supported by an active audit function. However, this function has limited capacity to audit all the organizations that have delegated authority.

11.105 The Treasury Board is the government's management board. As outlined in the FAA, the Treasury Board acts on all matters relating to administrative policy, financial management, expenditure plans, programs and priorities of departments, human resources management, and other issues related to the prudent and effective use of public resources to support government objectives. The Treasury Board may make regulations and require reports from departments and agencies.

11.106 Each department and agency is expected to have an internal audit and program evaluation function, or to hire a contractor to perform it. We were informed by Treasury Board Secretariat officials that financial assistance and support was available to small agencies to conduct audits and evaluations. However, these three small independent agencies did not avail themselves of this financial assistance and support. The OCI and the other two small agencies we examined do not have an internal audit and program evaluation function, and do not contract it out, leaving them more vulnerable to risks.

11.107 From discussions with the Office of the Comptroller General, we learned that it has not undertaken any financial or performance audits of small agencies except for one.

11.108 Recommendation. The Treasury Board Secretariat should begin monitoring small independent agencies to assess the effectiveness of their management and financial control frameworks, and to ensure they comply with applicable Treasury Board policies and practices. The Treasury Board Secretariat should also conduct internal audits of small independent agencies.

Treasury Board Secretariat's response. Agreed. Small agencies, including the Office of the Correctional Investigator (OCI), are monitored through the Management Accountability Framework (MAF) exercise that establishes accountabilities between departments and agencies, including their deputy heads, and the Treasury Board Secretariat in relation to management and financial control frameworks. It should be noted that the human resources component of the MAF does not apply to separate agencies such as OCI.

The new Treasury Board Policy on Internal Audit that came into effect in April 2006 has a particular focus on small departments and agencies. Under the policy, the Office of the Comptroller General will undertake internal audits of small departments and agencies. The first such audit has been launched. New protocols for internal audit services to small departments and agencies have been developed and financial assistance totalling $27 million has been made available to all departments and agencies to build internal audit capacity.

11.109 Recommendation. The Treasury Board Secretariat and the Privy Council Office should ensure there is periodic monitoring of small independent agencies.

Treasury Board Secretariat's response. Agreed. Small independent agencies are monitored through the Management Accountability Framework (MAF) exercise. The human resources component of the MAF does not apply to separate employers such as the Office of the Correctional Investigator. However, the Public Service Human Resources Management Agency of Canada (PSHRMAC) does monitor management of departmental performance management programs for executives in all departments and agencies that form part of the core public service. As well, the PSHRMAC is completing a classification monitoring exercise in which classification programs in a sample of 13 small departments and agencies were monitored. These monitoring programs are ongoing, but do not extend to separate employers. Finally, the Treasury Board Policy on Internal Audit provides for closer monitoring of small departments and agencies through audits undertaken by the Office of the Comptroller General.

Privy Council Office's response. The Privy Council Office will be informed of any anomalies identified through this monitoring, as outlined in the Treasury Board Secretariat's response, concerning heads of agencies appointed by the Governor in Council.

Special leave, management leave, and cash-out policies are unclear

11.110 The policy and guidelines concerning special leave for full-time Governor in Council appointees, such as the former Correctional Investigator, are unclear, leaving room for abuse. It is also unclear who authorizes the cash-out of unused annual leave for full-time Governor in Council appointees, who are agency heads.

11.111 Full-time Governor in Council appointees are allowed to take special leave with pay for reasons other than vacations or illness—for example, time in lieu of excessive hours worked.

11.112 Full-time Governor in Council appointees apply to their deputy head for special leave with pay. This would be the case when there is more than one Governor in Council appointee in an organization. There are no guidelines about what constitutes excessive hours of work, nor any indication of who must approve the leave for heads of agencies. Granting significant additional leave effectively changes the compensation such people receive.

11.113 In March 2004, the Office of the Auditor General raised the following four issues with the Privy Council Office and the Public Service Human Resources Management Agency (PSHRMAC). We asked them to clarify and act on these issues:

- lack of guidance concerning the use of special leave with pay;
- lack of clarity concerning authorities for approving special leave with pay, especially for full-time Governor in Council appointees who head agencies;
- inconsistent application of the cash-out policy for unused annual leave; and
- inconsistent or non-existent reporting of leave for senior officials.

11.114 In March 2005, the PSHRMAC issued additional guidance for deputy heads regarding executives' use of special leave with pay. PSHRMAC and Treasury Board officials advised us that they are working toward a single integrated policy for all matters related to executives. The new policy and directives outlining administrative procedures are expected by the end of 2006–07.

11.115 The Privy Council Office has not issued further guidance to agency heads on special leave, management leave, and cash-out policies. It indicated that this matter would be discussed in the near future by the Advisory Committee on Senior Level Retention and Compensation.

11.116 Recommendation. The Privy Council Office should issue clear guidelines on policies for full-time Governor in Council appointees, regarding management and special leave and cash-out of annual leave. The guidelines should specify who approves leave and cash-out of annual leave for Governor in Council appointees who are heads of departments and agencies. The Privy Council Office should monitor the way full-time Governor in Council appointees take management and special leave, and how they cash out their annual leave.

Privy Council Office's response. Agreed. Heads of agencies are responsible for managing leave and cash-out of annual leave of appointees within their organization. The Privy Council Office is developing guidelines that will provide guidance to deputy heads with respect to the approval, usage, and reporting of their own leave and cash-out of annual leave. This reporting requirement will serve as the basis for the monitoring of these matters.

Conclusion

11.117 We found abuses and wrongdoing at the Office of the Correctional Investigator (OCI). The former Correctional Investigator approved and directed certain improper payments and purchases, some of which resulted in substantial personal benefit. Improper payments to the former Correctional Investigator include payments for unearned salary, cash-out of annual leave, non-business travel and hospitality expenses, and purchase of computer equipment for non-business use. Improper payments to OCI employees were those that were recorded as overtime.

11.118 We identified significant absences by the former Correctional Investigator during business days for which he did not report taking leave and no OCI work could be identified. The former Correctional Investigator did not properly fulfill his responsibilities.

11.119 We determined that OCI senior managers' travel and hospitality claims from 2000–01 to 2003–04 were reimbursed in accordance with Treasury Board policies and directives. However, we have concerns about the annual leave reporting and cash-out of annual leave by some senior managers.

11.120 We found that OCI human resources management practices were poor. Many did not comply with Treasury Board policies and practices or meet the Public Service Commission's staffing values.

11.121 The Department of Public Safety and Emergency Preparedness Canada (PSEPC) did not fulfill its responsibility to provide adequate financial and human resources services to OCI, because it did not challenge questionable expenditures and problematic classification and staffing practices that the former Correctional Investigator had requested and approved.

11.122 The Treasury Board Secretariat and the Privy Council Office did not adequately oversee the OCI to ensure it complied with applicable government policies and practices. It did not ensure the organization was well-managed, and therefore did not identify or stop the inappropriate activities.

11.123 Several organizations receive certain administrative services from larger departments because of a lack of resources and capacity. In the absence of any oversight mechanism for 38 independent organizations, we believe that the government is exposed to an unnecessary level of risk of improper activities.

11.124 We determined that PSEPC provides financial and human resources services to two other small independent agencies in the same manner as the services provided to OCI. We believe that the procedures and practices at PSEPC and at the three small independent agencies are not adequate to minimize the risk of inappropriate transactions. However, we emphasize that the abuses and wrongdoing identified in this chapter are applicable only to the OCI.

11.125 In view of the concerns our audit of the OCI has raised, we are currently auditing the other two small independent agencies to which PSEPC provides financial and human resources services. That audit is focusing on comptrollership and senior management compensation, absences, cash-out of annual leave, travel and hospitality expenditures, and human resources practices.

Office of the Correctional Investigator's overall response. The Office of the Correctional Investigator (OCI) shares the concerns raised by the Auditor General's report, and is fully committed to do what is necessary to address each recommendation and ensure public confidence in this important federal institution.

The OCI fully agrees with the four recommendations of the Office of the Auditor General of Canada (OAG) specifically directed at the OCI. The OCI supports new initiatives and OAG recommendations that will enhance accountability and transparency of government agencies and departments. This Office has specifically indicated to all involved departments that it wishes to fully participate in the

development of government-wide enhanced accountability measures that will result in improved financial and human resource management. This Office will cooperate with efforts to identify and recover money improperly paid out, as recommended by the OAG.

It is important to note that during the six-year period audited, the Office fulfilled its legal mandate by responding to more than 40,000 offender complaints. The OCI staff conducted more than 16,000 individual interviews and spent more than 2,100 days visiting penitentiaries. It also reviewed almost 750 Correctional Service Canada investigative reports dealing with offender injuries or deaths.

Shortly after his appointment, the current Correctional Investigator was briefed by management on the findings of the Auditor General's audit of OCI human resource practices. Work then began to develop a number of initiatives to modernize and enhance the Office's administrative practices, including implementing more effective internal control mechanisms. The modernization of the Office has included a complete review of its governance structure, financial and human resource management framework, and a re-examination of performance measurement and reporting requirements consistent with government-wide TBS initiatives.

The key initiatives adopted by the current Correctional Investigator since his appointment to strengthen governance, financial management and accountability, human resources management, and performance measurement and reporting can be reviewed at our Internet site at www.oci-bec.gc.ca.

About the Audit

Objective

The objective of our audit was to examine the practices and activities of the Office of the Correctional Investigator (OCI) senior managers and the former Correctional Investigator. We sought to identify, examine, and report any cases of questionable practices and suspected wrongdoing related to financial expenditures and human resources management. We wished to ascertain whether senior managers and the former Correctional Investigator

- were absent extensively, received proper salaries, and recorded and cashed out annual leave entitlements properly;
- submitted travel claims and expenses appropriately and were reimbursed in accordance with Treasury Board policy and directives;
- submitted hospitality claims appropriately and were reimbursed for these expenses in accordance with Treasury Board policy;
- submitted expenditures that were incurred in accordance with Treasury Board policies and with prudence and probity; and
- managed human resource staffing practices appropriately.

We also examined the financial and human resources services that Public Safety and Emergency Preparedness Canada (PSEPC), formerly the Department of the Solicitor General, provided to OCI. Our objective was to determine if the Department supplied the services in accordance with the *Financial Administration Act* (FAA), and in compliance with applicable Treasury Board Secretariat and Public Service Commission policies and practices, and with prudence and probity. Our audit objective also included determining whether the Treasury Board Secretariat, the Public Service Commission, and the Privy Council Office adequately oversaw the OCI.

Scope and approach

The audit focused on the activities of OCI's senior managers and the former Correctional Investigator for the period from 1 April 1998 to 31 March 2004. Some transactions relating to annual leave were examined back to an earlier date. The audit did not examine the OCI program. In addition, we examined some of the financial and human resources services PSEPC provided to OCI.

We interviewed current and former senior managers and employees at OCI, as well as the former Correctional Investigator. We also interviewed employees of PSEPC, the Treasury Board, the Public Service Commission, and the Privy Council Office. We reviewed pertinent OCI, PSEPC, Treasury Board, Public Service Commission, and Privy Council Office records.

As a result of our findings, we extended the scope of this audit to review services PSEPC provided to two other small independent agencies. We also reviewed whether the Treasury Board Secretariat, the Public Service Commission, and the Privy Council Office adequately oversaw these two agencies.

Criteria

The following criteria guided our audit work:

- Senior managers' salaries and cash-out of annual leave are governed by the FAA, government regulations and policies, and should be incurred with prudence and probity.
- Government regulations and policies govern the types of leave senior managers take, and these leaves are to be managed with prudence and probity.
- Senior managers should work the hours their terms and conditions of employment stipulate, and they should provide evidence of work performed during unreported absences from OCI business premises.
- Travel and hospitality expenditures are regulated in accordance with the FAA; government regulations policies, and directives; and should be incurred with prudence and probity.
- Human resources are managed in accordance with government regulations, policies and practices.
- Financial transactions are certified and processed in accordance with the FAA and Treasury Board policies, and with prudence and probity.

Audit work completed

Audit work for this chapter was substantially completed on 17 August 2006.

Audit team

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 11. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Organizations' responses
Improper and questionable payments	
11.35 The Office of the Correctional Investigator, the Treasury Board Secretariat, and the Privy Council Office should submit a report to Parliament setting out the actions that will be taken to identify and recover, where possible, any amount of money improperly paid out, as identified in this report, and the time frame for accomplishing these tasks. **(11.12–11.34)**	**Each organization provided the same response.** Agreed. The Office of the Correctional Investigator, the Treasury Board Secretariat, and the Privy Council Office will submit a report to Parliament setting out the actions that will be taken to identify and recover money improperly paid out, and the time frame for accomplishing these tasks.
11.36 The Office of the Correctional Investigator, Public Safety and Emergency Preparedness Canada, and the Treasury Board Secretariat should review the questionable payments for cash-out of annual leave to the former Correctional Investigator for 1990–91 to 1997–98, to determine if the amounts paid out to him were warranted. **(11.23–11.24)**	**Each organization provided the same response.** Agreed. The Office of the Correctional Investigator, in conjunction with the Treasury Board Secretariat and Public Safety and Emergency Preparedness Canada, will review the cash-out of annual leave to the former Correctional Investigator for 1990–91 to 1997–98.
Personal use of a government vehicle	
11.44 Public Safety and Emergency Preparedness Canada should review the basis on which it calculated the former Correctional Investigator's taxable benefits for the use of the government vehicle. PSEPC should correct the amounts of taxable benefits it reported for all applicable years. **(11.42–11.43)**	**Public Safety and Emergency Preparedness Canada's response.** The Department relied on the information provided by the former Correctional Investigator to calculate the original taxable benefit amount and has no documentation on which to base a recalculation. The matter will be referred to the Canada Revenue Agency for any action deemed appropriate.

Recommendation	Organizations' responses
Human resources practices	
11.57 Public Safety and Emergency Preparedness Canada should certify and process only human resources and staffing actions that comply with Treasury Board and Public Service Commission policies and practices. (11.50–11.56)	**Public Safety and Emergency Preparedness Canada's response.** Agreed. The Department will only certify and process staffing actions that are consistent with the Office of the Correctional Investigator's (OCI) Appointment Delegation and Accountability Instrument, and OCI staffing policies. Where there are no OCI policies, Treasury Board and Public Service Commission policies that are relevant will apply.
11.63 The Office of the Correctional Investigator (OCI), Public Safety and Emergency Preparedness Canada, and the Treasury Board Secretariat should immediately ensure that the OCI has an effective management control framework in the key areas of financial management and human resources management. (11.50–11.62)	**Office of the Correctional Investigator's response.** Agreed. Since the appointment of the current Correctional Investigator, the Office of the Correctional Investigator undertook, in consultation with the Treasury Board Secretariat (TBS) and Public Safety and Emergency Preparedness Canada, an extensive initiative to modernize the Office's management practices and the implementation of more effective internal control mechanisms. The modernization of the Office included a complete review of its governance structure, financial and human resource management framework, and a re-examination of performance measurement and reporting requirements consistent with government-wide TBS initiatives. The Office has sought third-party independent advice on the adequacy of its current internal control mechanisms. **Public Safety and Emergency Preparedness Canada's response.** Agreed. Public Safety and Emergency Preparedness Canada (PSEPC) will provide advice and assist OCI in establishing more effective management practices and control mechanisms. In exercising section 33 authority, PSEPC financial officers will ensure the adequacy of section 34 account verification and ensure that it is being properly and conscientiously followed. **Treasury Board Secretariat's response.** Agreed. The Treasury Board and its Secretariat provide general oversight, not day-to-day supervision or control, of departments. Ministers are accountable for respecting Treasury Board financial and administrative policies and, in turn, all deputy heads, including the Correctional Investigator, are expected to follow Treasury Board financial management policies. Bill C-2, The Federal Accountability Act, should it come into force, will reinforce the responsibilities and accountabilities of deputy heads, as "Accounting Officers," in such areas as compliance with

Recommendation	Organizations' responses
	government policies, internal control, and signing departmental accounts. In addition, the Federal Accountability Action Plan has mandated a senior committee of deputy ministers to strengthen and streamline Treasury Board financial management policies. This includes an effective financial management control framework. The Treasury Board Secretariat will work with Public Safety and Emergency Preparedness Canada and the Office of the Correctional Investigator to ensure financial management roles and accountabilities are clearly understood. As a separate agency, however, accountability for human resource management rested solely with the Correctional Investigator. Neither the Treasury Board Secretariat nor the Public Service Human Resources Management Agency of Canada (PSHRMAC) had the authority or accountability to oversee the human resource practices of the OCI. However, PSHRMAC is available to provide advice and guidance to OCI to set up an effective human resources management framework.
Comptrollership and management	
11.77 The Treasury Board Secretariat should ensure that every small independent organization has a senior financial officer formally designated and appropriately trained on his or her responsibilities and duties. **(11.68–11.76)**	**Treasury Board Secretariat's response.** Agreed. As noted in our response to the recommendation at paragraph 11.63, Treasury Board financial management policies are being reviewed by a senior committee of deputy ministers. This review includes the consideration of a new Chief Financial Officer Model for the Government of Canada, including their appointment, competencies, responsibilities, and accountabilities. In the meantime, the current Treasury Board Policy on Responsibilities and Organization for Comptrollership requires deputy heads of all organizations, including the Office of the Correctional Investigator, to designate a senior financial officer having a direct reporting relationship to the deputy head.
11.78 The Treasury Board Secretariat should advise and consult with management of small independent agencies to ensure that they fully understand their responsibilities if they become aware of inappropriate activities by the head of their agencies. **(11.68–11.76)**	**Treasury Board Secretariat's response.** Agreed. The Treasury Board Secretariat will work with small departments and agencies to ensure that the roles and accountabilities of senior financial officers under the current policy are clearly understood. This includes the steps that should be taken when the senior financial officer believes the actions of the deputy head place the department at risk or violate the spirit or form of legislation or policy.

Recommendation	Organizations' responses
11.86 Public Safety and Emergency Preparedness Canada should take greater care in fulfilling its role in supplying financial and human resources services. The Department should challenge and, if necessary, refuse to process financial or human resources requests that do not comply with applicable Treasury Board policies and practices and the *Financial Administration Act*. **(11.79–11.85)**	**Public Safety and Emergency Preparedness Canada's response.** Agreed. The Department has issued a directive to its human resources (HR) personnel that states that, as HR service providers, their role is to ensure that the advice and services provided to each agency respect the legislative, policy, and regulatory context as well as public service values and ethics, collective agreements, staffing values, and best practices. It has also taken steps to ensure that its financial officers are informed of their respective responsibilities related to the provisions of financial services.
11.87 The Office of the Correctional Investigator should enter into a signed Memorandum of Understanding with Public Safety and Emergency Preparedness Canada (PSEPC). This agreement should specify the financial and human resources services PSEPC will supply, the service standards that should be met, and the roles and responsibilities of each party. **(11.79–11.85)**	**Organizations' response.** The Office of the Correctional Investigator (OCI) and Public Safety and Emergency Preparedness Canada will enter into a Memorandum of Understanding (MOU), which outlines each organization's role and responsibilities, as well as the finance, human resources, information management/information technology, and security services to be provided. The OCI has sought third-party independent advice on this MOU. This will provide further assurance that this new MOU best responds to this important recommendation of the Auditor General.
11.92 The Treasury Board Secretariat should reinforce existing guidelines on the responsibilities and accountabilities of service providers. **(11.79–11.91)**	**Treasury Board Secretariat and Privy Council Office provided the same response.** Agreed. Legislation and current Treasury Board policies outline certain requirements relating to the provision of services to others and the exercising of duties. The Treasury Board Secretariat (TBS) will review current guidance to determine if revisions are required. In addition, the TBS will work with departments and agencies to provide a better understanding of these responsibilities and accountabilities to reduce the likelihood of similar incidents occurring in the future. The TBS will also remind departments and agencies of the need for Memoranda of Understanding when services are provided to or for others. Finally, the TBS will work with the Privy Council Office to update management and financial accountabilities for the *Guide Book for Heads of Agencies* should Bill C-2, the Federal Accountability Act, come into force.

Recommendation	Organizations' responses
11.93 Public Safety and Emergency Preparedness Canada (PSEPC) should enter into a Memorandum of Understanding with each of the other two small independent agencies to which it provides financial and human resources services. These agreements should specify the financial and human resources services PSEPC will supply, the service standards that should be met, and the roles and responsibilities of each party. **(11.88–11.91)**	**Public Safety and Emergency Preparedness Canada's response.** Agreed. PSEPC and the two agencies will enter into Memoranda of Understanding that will outline each organization's role and responsibilities as well as the finance, human resources, information management/information technology, and security services to be provided.
11.99 The Privy Council Office, in consultation with the Treasury Board Secretariat, should clearly establish the accountability of the heads of small independent agencies on matters related to financial management and human resources management. **(11.94–11.98)**	**Privy Council Office's response.** Agreed. The Privy Council Office will revise its *Guide Book for Heads of Agencies*, which sets out the role of heads of agencies with respect to operations, structures, and responsibilities in the federal government, including a section on the exercise of their responsibility and accountability as defined by statute and by convention. These revisions will provide more details on agency heads' accountability for the management of their organization and clarify their roles and responsibilities as deputy heads.

Recommendation	Organizations' responses
11.100 The Privy Council Office should ensure that it appropriately advises and trains full-time Governor in Council appointees about their expected standards of conduct as holders of public office. (11.94–11.98)	**Privy Council Office's response.** Agreed. The Privy Council Office will provide more detailed information when advising appointees, prior to their appointment, of the conflict of interest rules and other standards of conduct that apply to them. Upon appointment, appointees are contacted by the Office of the Ethics Commissioner to discuss any concerns they may have with respect to their office. The Privy Council Office will provide further written advice to appointees on these matters, following their appointment. In addition, the section in the *Guide Book for Heads of Agencies* that explains how public service values and probity apply to them will be enhanced to provide more detailed advice. Also, the booklet entitled *Terms and Conditions of Employment for Full-Time Governor in Council Appointees* will be amended by adding a section on standards of conduct. The Canada School of Public Service provides formal orientation and training sessions for heads of agencies. It is proposed that such training become mandatory for heads of agencies. Individual sessions with Treasury Board Secretariat and Privy Council Office officials, which are currently available upon request, will be provided to agency heads upon their appointment.
11.108 The Treasury Board Secretariat should begin monitoring small independent agencies to assess the effectiveness of their management and financial control frameworks, and to ensure they comply with applicable Treasury Board policies and practices. The Treasury Board Secretariat should also conduct internal audits of small independent agencies. (11.104–11.107)	**Treasury Board Secretariat's response.** Agreed. Small agencies, including the Office of the Correctional Investigator (OCI), are monitored through the Management Accountability Framework (MAF) exercise that establishes accountabilities between departments and agencies, including their deputy heads, and the Treasury Board Secretariat in relation to management and financial control frameworks. It should be noted that the human resources component of the MAF does not apply to separate agencies such as OCI. The new Treasury Board Policy on Internal Audit that came into effect in April 2006 has a particular focus on small departments and agencies. Under the policy, the Office of the Comptroller General will undertake internal audits of small departments and agencies. The first such audit has been launched. New protocols for internal audit services to small departments and agencies have been developed and financial assistance totalling $27 million has been made available to all departments and agencies to build internal audit capacity.

Recommendation	Organizations' responses
11.109 The Treasury Board Secretariat and the Privy Council Office should ensure there is periodic monitoring of small independent agencies. **(11.104–11.107)**	**Treasury Board Secretariat's response.** Agreed. Small independent agencies are monitored through the Management Accountability Framework (MAF) exercise. The human resources component of the MAF does not apply to separate employers such as the Office of the Correctional Investigator. However, the Public Service Human Resources Management Agency of Canada (PSHRMAC) does monitor management of departmental performance management programs for executives in all departments and agencies that form part of the core public service. As well, the PSHRMAC is completing a classification monitoring exercise in which classification programs in a sample of 13 small departments and agencies were monitored. These monitoring programs are ongoing, but do not extend to separate employers. Finally, the Treasury Board Policy on Internal Audit provides for closer monitoring of small departments and agencies through audits undertaken by the Office of the Comptroller General. **Privy Council Office's response.** The Privy Council Office will be informed of any anomalies identified through this monitoring, as outlined in the Treasury Board Secretariat's response, concerning heads of agencies appointed by the Governor in Council.
11.116 The Privy Council Office should issue clear guidelines on policies for full-time Governor in Council appointees, regarding management and special leave and cash-out of annual leave. The guidelines should specify who approves leave and cash-out of annual leave for Governor in Council appointees who are heads of departments and agencies. The Privy Council Office should monitor the way full-time Governor in Council appointees take management and special leave, and how they cash out their annual leave. **(11.110–11.115)**	**Privy Council Office's response.** Agreed. Heads of agencies are responsible for managing leave and cash-out of annual leave of appointees within their organization. The Privy Council Office is developing guidelines that will provide guidance to deputy heads with respect to the approval, usage, and reporting of their own leave and cash-out of annual leave. This reporting requirement will serve as the basis for the monitoring of these matters.

Office of the Correctional Investigator's overall response

The Office of the Correctional Investigator (OCI) shares the concerns raised by the Auditor General's report, and is fully committed to do what is necessary to address each recommendation and ensure public confidence in this important federal institution.

The OCI fully agrees with the four recommendations of the Office of the Auditor General of Canada (OAG) specifically directed at the OCI. The OCI supports new initiatives and OAG recommendations that will enhance accountability and transparency of government agencies and departments. This Office has specifically indicated to all involved departments that it wishes to fully participate in the development of government-wide enhanced accountability measures that will result in improved financial and human resource management. This Office will cooperate with efforts to identify and recover money improperly paid out, as recommended by the OAG.

It is important to note that during the six-year period audited, the Office fulfilled its legal mandate by responding to more than 40,000 offender complaints. The OCI staff conducted more than 16,000 individual interviews and spent more than 2,100 days visiting penitentiaries. It also reviewed almost 750 Correctional Service Canada investigative reports dealing with offender injuries or deaths.

Shortly after his appointment, the current Correctional Investigator was briefed by management on the findings of the Auditor General's audit of OCI human resource practices. Work then began to develop a number of initiatives to modernize and enhance the Office's administrative practices, including implementing more effective internal control mechanisms. The modernization of the Office has included a complete review of its governance structure, financial and human resource management framework, and a re-examination of performance measurement and reporting requirements consistent with government-wide TBS initiatives.

The key initiatives adopted by the current Correctional Investigator since his appointment to strengthen governance, financial management and accountability, human resources management, and performance measurement and reporting can be reviewed at our Internet site at www.oci-bec.gc.ca.

Report of the Auditor General of Canada to the House of Commons—November 2006

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Chapter 12

Role of Federally Appointed Board Members—
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Office of the Auditor General of Canada



2006



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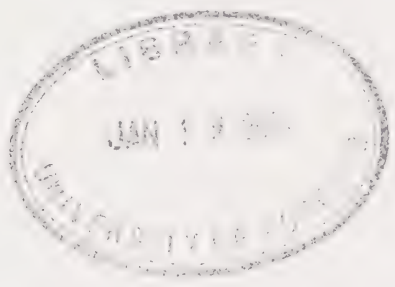
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Chapter 12

Role of Federally Appointed Board Members—
Sustainable Development Technology Canada

Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.



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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2006
Cat. No. FA1-2006/1-12E
ISBN 0-662-44376-4

Chapter

12

Role of Federally Appointed Board Members

Sustainable Development Technology Canada

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Role of Federally Appointed Board Members

Sustainable Development Technology Canada

Main Points

What we examined

Sustainable Development Technology Canada (SDTC) is a not-for-profit foundation established by the federal government to support the development and demonstration of technologies related to climate change, clean air, clean soil, and clean water. The government has provided it with $550 million under three successive funding agreements with Natural Resources Canada and Environment Canada.

In the third funding agreement, signed in March 2005, the government introduced a change that affected the role of those members of the SDTC Board of Directors who were federally appointed. This raised certain concerns about the governance of the Foundation, which we decided to examine.

Why it's important

In a "board-centred" model of governance, the board of directors is responsible for the supervision of the business and affairs of the organization. The government has acknowledged that federally appointed members of the boards of directors of foundations such as SDTC are obliged, like every other board member, to act in the best interests of the organization.

What we found

- Seven of the fifteen members of SDTC's Board are appointed by the federal government. The government's change to its funding agreement with the Foundation prevents the Board from making any decisions in a meeting where a majority of members present are government appointees. To resolve this problem, the Board passed a by-law providing for a subsequent vote by the other board members, but directors told us that the process is inefficient and hampers the Board's ability to operate. Given that the Board generally meets only four times a year, the change in the funding agreement makes it difficult for the Board to govern the Foundation's affairs.
- The government's change in the funding agreement interfered with the ability of federally appointed directors to carry out their duties.

The government has responded. Natural Resources Canada and Environment Canada agreed with our recommendation on behalf of the government. They have undertaken consultations with the Treasury Board Secretariat and the Privy Council Office regarding restrictions on the participation of federal appointees on the SDTC Board.

Introduction

12.1 Sustainable Development Technology Canada (SDTC or the Foundation) is a not-for-profit foundation that has received three grants—for a total of $550 million—from the federal government to fund its activities. It serves public policy purposes, under legislation and three successive funding agreements with the ministers of the sponsoring departments: Natural Resources Canada and Environment Canada.

12.2 The Foundation was established by the *Canada Foundation for Sustainable Development Technology Act* in June 2001. It finances and supports the development and demonstration of new sustainable development technologies related to climate change, clean air, clean water, and clean soil.

12.3 The Foundation's mission is to act as the primary catalyst in building a sustainable development infrastructure in Canada. To achieve this mission it

- awards funds to develop and demonstrate new sustainable development technologies,
- fosters and encourages collaboration and partnerships among different organizations, and
- ensures timely diffusion of these technologies in relevant market sectors.

12.4 The Foundation was set up to complement the sustainable development activities of a number of government departments.

12.5 The Foundation is governed by a Board of Directors that reflects the broad interests of the public, private, and academic sectors in Canada. The Board of Directors is composed of fifteen individuals:

- seven, including the Chair, who are appointed by the Government of Canada through a Governor in Council appointment; and
- eight, who are appointed by members of the Foundation.

12.6 In the third funding agreement of March 2005 with the Foundation, the Treasury Board Secretariat required the insertion of a clause that prevents the Board from making decisions in a meeting where a majority of directors present are government appointees. The Foundation raised concerns about how the clause will affect Board governance. These concerns led us to undertake the audit.

Focus of the audit

12.7 We examined how the change in the March 2005 funding agreement affected the role of federal appointees to the Board of Directors. Our objective was to determine whether the government's position on the role of federal appointees to the Foundation's Board of Directors supported effective board governance.

12.8 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendation

Governance of the Foundation's affairs

12.9 We expected that the Treasury Board Secretariat would provide guidance to the sponsoring departments, Natural Resources Canada and Environment Canada, that supports good governance; and that the sponsoring departments would follow this guidance and make provisions for good governance arrangements through the funding agreement.

New clause impedes the Board's operations

12.10 In March 2005, the Treasury Board Secretariat asked officials at the two sponsoring departments, Natural Resources Canada and Environment Canada, to insert the following clause in the revised funding agreement:

> The Foundation agrees that the federal government appointees to the Board will not comprise a majority proportion or number required to attain quorum or to effect any decision of the Foundation, the Board, or any committee thereof, or necessary to comply with the by-laws of the Foundation.

12.11 Although the Foundation objected to this clause, the Secretariat insisted that the sponsoring departments insert it as a condition for the Foundation to receive funding initially allocated in the 2004 Budget.

12.12 Officials at the Treasury Board Secretariat informed us that the government included the new clause to eliminate the existence or appearance of government control of the Foundation. The issue of control is the basis for determining whether a foundation is part of the government's accounting entity. However, we noted the government's decision, announced in the 2006 Budget, to include Sustainable Development Technology Canada's revenues and expenses in its financial statements. This decision effectively places the Foundation

within the federal government's reporting entity. Therefore, the government's reason for having the clause no longer exists.

12.13 In our interviews with the Foundation's senior managers and several directors, we were told that the new clause is considered unduly restrictive. Often, it is difficult to ensure that the majority of directors at Board meetings are not government appointees. Under this clause, the Board cannot make any decisions during a meeting if government appointees are in the majority. As the Board generally meets only four times a year, this could seriously affect its operations.

12.14 In the spring of 2005, the Foundation introduced a new by-law to address the difficulties arising from the clause. If a decision is made and the federal government appointees are in the majority, the by-law requires a second vote by the non-government appointees. When we interviewed the directors, they told us that this two-step process was inefficient, and that it impeded the Board's operations.

12.15 We noted that some other organizations with federal funding have similar clauses in their funding agreements or in their legislation. In our view, the governance structure of these organizations is different from that of Sustainable Development Technology Canada.

12.16 We found that the clause is unduly restrictive and that it is no longer relevant given the decision announced in the 2006 Budget to include the Foundation's revenues and expenses in the government's financial statements.

New clause interferes with the role of federally appointed directors

12.17 In our April 2002 Report, Chapter 1, Placing the Public's Money Beyond Parliament's Reach, we recommended that the Privy Council Office ensure that sponsoring departments fully define the roles and responsibilities of federal appointees to boards. In its response to this recommendation, the Privy Council Office focused on the guidance it provides to newly appointed chairs of Crown corporations and heads of agencies. However, it also referred to the requirement of the *Canada Business Corporations Act* that directors act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances. The directors of the Foundation are subject to this requirement.

12.18 The 14th Report of the House of Commons Standing Committee on Public Accounts considered Chapter 1 of our

2002 April Report. In October 2003, the government responded to the Committee's 14th Report and stated that

> On the matter of [the] roles and responsibilities of federal appointees to boards of directors, such appointees do not represent the Department or the government. Instead, they have a responsibility to their boards and therefore their actions would be governed by the Foundation's by-laws, the Acts they are established under, as well as the policies and guidelines issued by the boards. Board directors also have a fiduciary responsibility to act in the best interest of the foundations. Guidance to federal appointees regarding their responsibilities as board directors should therefore come from the foundations themselves.

12.19 These responses speak to the roles and responsibilities of federally appointed board members. In our view, every director has a fiduciary duty to actively participate in the function of the Board, that is, in supervising the management of the business and affairs of the Foundation. The new clause prevents federal government appointees from forming a majority of the persons required to form a quorum or to make any decision of the Foundation. It interferes with their ability to carry out their duties and influence matters relating to the supervision of the Foundation's business, since their views and votes will only be counted in situations where government appointees are in a minority.

12.20 Treasury Board Secretariat officials informed us that the new clause (see paragraph 12.10) deals with quorum, not the role of board members. However, we do not agree. In our view, the new clause has a direct impact on how federal government appointees participate in board meetings.

12.21 Recommendation. Natural Resources Canada and Environment Canada should consult the Treasury Board Secretariat and the Privy Council Office to clarify the necessity of restricting the participation of federal government appointees to the Board of Directors of Sustainable Development Technology Canada in the decision-making process.

The government's response. The government agrees. Natural Resources Canada and Environment Canada have initiated discussions with the Treasury Board Secretariat and the Privy Council Office regarding restrictions on the participation of federal appointees on the Board of Directors of Sustainable Development Technology Canada. Consultations are scheduled to be completed in November 2006.

Conclusion

12.22 The government's decision to restrict the role of federally appointed directors

- affected the Board's governance, and
- interfered with the ability of federally appointed directors to carry out their duties.

About the Audit

Objective

Our objective was to determine whether the government's position on the role of federal appointees to the Board of Directors supported effective board governance for Sustainable Development Technology Canada.

Scope and approach

We reviewed documents and interviewed senior officials from the following five entities:

- Sustainable Development Technology Canada,
- Natural Resources Canada,
- Environment Canada,
- Treasury Board Secretariat, and
- Privy Council Office.

Criteria

We expected that

- the Treasury Board Secretariat, on behalf of the government, would provide guidance to the sponsoring departments that supports good governance;
- the sponsoring departments would follow the Secretariat's guidance and make provisions for good governance arrangements through the funding agreement; and
- the Foundation would promote good governance arrangements.

Audit work completed

Audit work for this chapter was substantially completed in May 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 12. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraph where the topic is discussed.

Recommendation	Government's response
Governance of the Foundation's affairs	
12.21 Natural Resources Canada and Environment Canada should consult the Treasury Board Secretariat and the Privy Council Office to clarify the necessity of restricting the participation of federal government appointees to the Board of Directors of Sustainable Development Technology Canada in the decision-making process. (12.9–12.20)	The government agrees. Natural Resources Canada and Environment Canada have initiated discussions with the Treasury Board Secretariat and the Privy Council Office regarding restrictions on the participation of federal appointees on the Board of Directors of Sustainable Development Technology Canada. Consultations are scheduled to be completed in November 2006.

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